INDIANA FRANCHISE LAW

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I.

INTRODUCTION

In 1975 the Indiana General Assembly enacted two statutes that impose a comprehensive regulatory scheme on commercial relationships based on franchise agreements. [1] A scant body of case law explaining and applying these statutes has slowly but steadily taken shape since their passage, but a comprehensive study of Indiana franchise law has yet to be published.[2] Ostensibly, the purpose of this article is to present an overview of Indiana's franchise statutes as well as an analysis of judicial decisions applying and interpreting their terms and provisions. A more subtle purpose is to explore Indiana franchise law in light of one of the most fundamental principles of the common law: the freedom to contract. The franchise contract is a powerful tool for exploring why legislatures have weakened this sacred common law principle. Unlike the vast majority of commercial contracts, the franchise agreement does not merely govern isolated commercial transactions, but rather establishes broad, long-term legal and economic relations; like the firm, the franchise vertically organizes economic activity by contract, with the typical franchise agreement establishing the respective capital contributions, rights, duties and duration of legal obligation of parties voluntarily joining in a commercial venture. Hence, legislative choices regarding the franchise reveal the extent to which contemporary legal and commercial communities are willing to rely upon the principle of the freedom to contract as a means for ordering legal relations in an equitable and economically sound manner. The Indiana franchise statutes, in turn, reflect, in the words of the Seventh Circuit, Indiana's "effort to balance, in a way that makes sense in the commercial and social life of Indiana, the freedom to enter into contracts and the need to regulate" the franchise.[3] An ancillary goal of this article is to examine the judicial art of statutory interpretation in the context of Indiana franchise law. The Indiana franchise statutes pose a particularly perplexing

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[1] I.C. §23-2-2.5-1 et seq. (1983); I.C. §23-2-2.7-1 et seq. (1987).

[2] In 1975, a survey of trends in commercial law included a section on the franchise statutes, see Bepko, Survey of Recent Developments in Indiana Law -Contracts and Commercial Law, 9 Ind. L. Rev. 132, 152 (1975). Professor Bepko noted the importance of these laws and provided an overview of their major provisions, but there were no reported cases to examine at that time.

[3] Wright-Moore Corp. v. Ricoh Corp., 908 F.2d 128, 142 (7th Cir. 1990).

problem to the courts that must interpret and apply their terms. First, as with most laws that govern a broad spectrum of behavior in complex interactions, these statutes articulate only vague standards, leaving the courts to fill in the details. Second, Indiana does not complement her laws with legislative history. Third, by their substantive terms, the statutes create diversity jurisdiction, often requiring the federal courts to interpret Indiana law with little guidance from Indiana courts.[4] Consequently, as bemoaned by the Seventh Circuit, courts often encounter the "black hole of legislative ambiguity" created by the Indiana franchise statutes.[5]

II.

PURPOSE AND SCOPE OF INDIANA FRANCHISE LAW

A. Legislative Purpose

Together, the Indiana Franchise Act[6] and the Indiana Deceptive Franchise Practices Act[7] ("Indiana Franchise Statutes") establish the legal framework and public policy of Indiana franchise law. The defining attribute of this law is that the statutes are decidedly protective rather than facilitative. First, unlike the Uniform Commercial Code which codifies and refines the common law to better facilitate commercial transactions, the Indiana Franchise Statutes derogate traditional principles of contract law to protect one party to a contract from the other. Second, these statutes utilize federalism to protect citizens of Indiana who contract with outsiders.

Indiana's skeptical attitude and sheltering instinct with regard to franchising is founded upon history and economic form. The franchise contract is inherently problematic because of the typical disparity between the respective bargaining power and economic risks of the contracting parties. After World War II, franchising became a popular method of mass distribution because of its "managerial and capital ease, combined with a greater freedom from anti-trust restraints."[8] In a typical franchise, a large, national corporation, the franchisor, sells goods and services by contracting out the bottom link of its distribution network -- that link where consumers deal directly with the network -- to a small, local dealer, the franchisee. Generally, but not necessarily, the franchisor brings superior economic and legal resources to the bargaining table. Furthermore, the typical franchisee must make a large firm-specific investment in return for the goodwill associated with the franchise; too often, the franchisee can accomplish this only by assuming a large debt and exposing life savings. Hence, the franchise relationship is ripe with the potential for coerced and duress bargaining.

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[4] See I.C. §33-24-3-6 (2004). Indiana courts are not authorized to answer certified questions on Indiana law submitted by the Federal District Courts.

[5] Wright-Moore, 908 F.2d at 142.

[6] I.C. §23-2-2.5-1 et seq.

[7] I.C. §23-2-2.7-1 et seq.

[8] Thomas Yannucci, ""'A Sui Genesis Approach To Franchise Terminations," 50 Notre Dame L.VR 545,545.

Given these disparities, freedom of contract has historically produced harsh economic consequences for franchisees, while traditional rules of contract law have failed to ameliorate this harshness. Franchise contracts have generally been viewed in the eyes of the law as "adhesion contracts because the parties are in an unequal bargaining position, and the provisions are highly favorable to the franchisor," with the franchisee having only "the opportunity to adhere to the contract or reject it."[9] However, whether such contracts are unenforceable is another issue altogether, and, indeed, absent other aggravating factors, franchise contracts of adhesion are generally enforceable. A contract may be unenforceable as unconscionable because it contains "unreasonable or unknown terms and is the product of inequality of bargaining power," but the unconscionability doctrine is a limited exception to the "court's general reluctance to alter the terms of an expressed contract."[10] Accordingly, this doctrine seldom relieves franchisees from harsh contract terms.

The initial disparity of power and the franchisee's economic vulnerability continue into the performance of the contract and often allow the franchisor to mandate conditions that keep the franchisee in a constant state of inferiority and danger.[11] However, while the franchisee's submission results from what a lay person would commonly understand as coercion and duress, the law generally will not void a contract as being procured under duress absent actual threats which destroy the free exercise of one's will.[12]

Perhaps the harshest franchise terms are those that trigger contractual termination; often, franchise contracts impose such strict terms on the franchisee's performance that the franchisor is virtually free to declare default at any time, liquidate the assets, and resale the franchise.[13] Occasionally, courts have imposed a fiduciary relationship on franchisees to avoid severely harsh terms, but this represents a desperate approach which contradicts the historical understanding of a fiduciary.[14] Judicial intervention, therefore, provides only infrequent and uncertain relief from one-sided contracts.

Recognizing the common law's inability to rectify the inequities inherent in the franchise contract or provide adequate remedies to curb abuse, many legislatures have provided explicit statutory protection for franchisees. The expressed and essential purpose of these laws is to impair the freedom to contract in order to protect the franchisee.[15] The Indiana Franchise

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[9] 62B Am.Jur.2d, Private Franchise Contracts, §174.

[10] Communication Maintenance. Inc. v. Motorola. Inc., 761 F.2d 1202, 1209 (7th Cir. 1985).

[11] Yannucci at 546.

[12] *See* Rutter v. Excel Industries. Inc. 438 N.E.2d 1030 (Ind. App. 1982); Raymundo v. Hammond Clinic Ass'n. 449 NE.2d 276 (Ind. 1983).

[13] *See* Yannucci at 556-557.

[14] *See* Yannucci at 556-557.

[15] *See*, Note, Constitutional Obstacles to State "Good Cause" Restrictions on Franchise Terminations 74 Column. L. Rev. 1487 (1974). As an example of the statutory purpose behind these laws, Wisconsin's franchise statute states that its purpose is to protect franchisees from "unfair treatment" by franchisors who "inherently have superior economic power and superior bargaining power." Wis.Stat. §135.025(2).

Statutes are silent as to purpose. Indeed, in *Wright-Moore*, the Seventh Circuit complained that "since Indiana's franchise law has no legislative history, we interpret Indiana's law by reference to similar laws in other states and the purposes behind those statutes,"[16] and then noted that "the purpose of most franchise laws is to protect franchisees who have unequal bargaining power."[17] As the dissent noted, "reasoning by analogy to case law developed in other jurisdictions is perilous."[18] However, given the substantive terms of the Indiana Franchise Statutes, it is abundantly clear that their purpose is protective.[19]

B. Statutory Definition of Franchise Contract: To Be or Not To Be A Franchise

To protect franchisees against the superior power of the franchisor, the Indiana Franchise Statutes establish a comprehensive regulatory scheme that governs the negotiation, the substance, the performance and even the termination of franchise contracts. Since registration and disclosure are vital to this protective scheme, the model regulated transaction is one whereby the parties understand that they are contemplating entering into a franchise agreement and resort to, and comply with, the Franchise Statutes at the beginning and throughout the commercial relationship. However, because Franchise contracts are similar to other commercial agreements — particularly dealership, license, service and sales agreements — the issue of whether an agreement regardless of title is indeed a de facto franchise contract is frequently litigated; often, this issue arises far into the commercial relationship, with franchisors often being subjected to the statutes only upon attempting to end the commercial relationship.

Accordingly, the Indiana Franchise Act begins by attempting to distinguish franchise contracts from other commercial agreements. I.C. §23-2-2.5-1(a) sets forth a three-prong test for determining when an agreement qualifies as a franchise contract under the Act.[20] Normally, each of these three elements must be satisfied.[21] However, if the agreement relates to "the business of selling automobiles and/or trucks and the business of selling gasoline and/or oil primarily for use in vehicles," then the last prong concerning franchise fees is not applicable.[22]

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[16] Wright-Moore, 908 F.2d at 135.

[17] Id.

[18] Wright-Moore, 908 F.2d at 142.

[19] See also, Implement Service. Inc. v. Tecumseh Products Co.. 726 F.Supp. 1171, 1176 (S.D. Ind. 1989).

[20] The Indiana Deceptive Franchise Practices Act, i.e. §23-2-2.7-1 et seq., incorporates this statutory definition.

[21] Master Abrasives Corp. v. Williams. 469 N.E.2d 1196 (Ind.Ct.App., 1984) (overruled on other grounds).

[22] I.C. §23-2-2.7-5; see also. Hoosier Penn Oil Co. v. Ashland Oil Co.. 934 F.2d 882 (7th Cir. 1991).

The test of whether a relationship falls within the definition of a "franchise" is fact-sensitive. The Franchise Disclosure Act defines a franchise as a contract by which:

A. A franchisee is granted the right to engage in the business of dispensing goods or services, under a marketing plan or system prescribed in substantial part by a franchisor;

B. The operation of the franchisee's business pursuant to such a plan is substantially associated with the franchisor's trademark, service mark, trade name, logotype, advertising, or other commercial symbol designating the franchisor or its affiliate; and

C. The person granted the right to engage in this business is required to pay a franchise fee.[23]

Two exceptions to falling within this definition are recognized:

1. When the franchisee has been in a similar business for at least two (years); and

2. When the parties anticipate that the franchised business will constitute only a small portion of the franchisee's total gross sales.[24]

Unless an exception applies, all three requirements of the statutory definition of a franchise must be satisfied before a franchise will be found to exist.[25]

The first step in defining a franchise contract is to determine exactly what contract is in dispute, as whether the Indiana Franchise Statutes govern a contract depends on how a court chooses to frame the contract. In *Montgomery v. Amoco Oil Co.*,[26] the plaintiff claimed that the defendant franchisor violated a provision of the Indiana Deceptive Franchise Practices Act which prohibits a franchise contract from containing a term allowing a substantial modification of agreement without the franchisee's written consent;[27] Amoco had imposed a credit card fee on the plaintiff during the time in which the parties were bound by the contract. The interesting aspect of this case is the District Court's finding that the contract dispute was not a franchise contract and the Seventh Circuit's avoidance of this issue.[28] That the parties were bound by a valid franchise contract was undisputed. However, the district court noted that Indiana presumes

[23] I.C. 23-2-2.5-1(a).

[24] Id.

[25] Master Abrasives Corp. v. Williams, 469 N.E.2d at 1199.

[26] 804 F.2d 1000 (7th Cir. 1986).

[27] See, I.C. §23-2-2.7-1(3).

[28] The Seventh Circuit upheld the judgment against plaintiff on the grounds that there was no contract term allowing unilateral modifications.

"that which is not in the instrument was intended to be left out,"[29] and concluded that since the credit card fee was not covered by the franchise contract, it was the subject of a separate contract rather than a modification of the parties original agreement. From here, the District Court reasoned that the Indiana Franchise Statutes were not applicable because the contract provisions complained of — the agreement covering the credit card fee — was not a franchise contract at all, since it granted no right to dispense in goods or services.[30]

1. Distribution of Goods and Services Per Franchisor's Marketing Plan

The first part of the definitional inquiry examines the nature of the business and turns on the extent to which the franchisor controls the business operations of the franchisee. I.C. §23-2-2.5-l(a)(1) states that:

(a) "Franchise" means a contract by which:

> (1) A franchisee is granted the right to engage in the business of dispensing goods or services, under a marketing plan or system prescribed in substantial part by a franchisor.[31]

This raises a mixed question of law and fact to be resolved through the court's examination of the commercial interactions between the parties and application of commercial conclusions.

The analysis under subsection (1) focuses on the extent to which the alleged franchisor retains control over the distribution of goods and services; this distinguishes franchise contract from sales and licensing agreements. With the model transaction likely envisioned by the legislature, a written instrument sets forth a formal, well-defined marketing plan that the franchisee is bound to obey, but absent such a plan, the courts will infer such a marketing plan from the various terms of an agreement and declare a de facto franchise. Courts first examine the agreement for terms that relate to the distribution of sales and services, and if such terms are present and are fairly rigid and integrate the business's sales strategy, courts find a plan sufficient to satisfy subsection (1).

While no Indiana case defines the criteria for the existence of "a marketing plan or system prescribed in substantial part by a franchisor," several cases offer guidance. In each case, "[t]he court examines the nature of the obligations that the agreement imposes upon the putative franchisee, particularly with respect to franchisor mandates regarding sales of goods or services."[32]

[29] Siler v. Colosino. 166 N.E. 667, 668 (Ind.Ct.App. 1929).

[30] Montgomery, 804 F.2d at 1004.

[31] I.C. §23-2-2.5-l(a)(1)

[32] Horner v. Tilton, 650 N.E.2d 759, 762 (Ind.Ct.App. 1995).

In *Cont'l Basketball Ass'n, Inc. v. Ellenstein Enters.*,[33] the Indiana Court of Appeals affirmed the trial court's decision finding that the putative franchisee operated under a marketing plan that was prescribed in substantial part by the putative franchisor.[34] This decision was premised on the alleged franchisee's agreement to comply with "the CBA [putative franchisor] by-laws, a 100-150 page 'Operations Manual' and the CBA's rules and regulations."[35] The court noted that:

> These documents controlled the transfer of title to an interest in the league, and nearly every other aspect of the selling of CBA professional basketball entertainment, including the acquisition and signing of coaches and players; the responsibilities of owners, business managers, general managers, coaches and players; personnel rules and official rules for play; playoff procedures and awards; procedures for the provision of concessions and souvenir sales; procedures for trainers; public relations; equipment suppliers; ticket and box office procedures; score-keeping and timing; public address announcements; security; and mascots and cheerleaders.[36]

In *Master Abrasives Corp. v. Williams*, Master, the alleged franchisor, sought to recover on a promissory note from Williams.[37] Williams counter-claimed for violations of the Indiana Franchise Disclosure Act.[38] The trial court entered judgment in favor of Williams and Master appealed.[39] The Indiana Court of Appeals first considered whether the agreement between Master and Williams constituted a franchise, and observed that the agreement between the parties:

- divided the state into marketing areas;
- authorized the establishment of sales quotas by Master;
- gave Master approval rights of any sales personnel whom Williams sought to employ; and
- established mandatory sales training by Master for Williams's sales personnel.[40]

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[33] 640 N.E.2d 705 (Ind.Ct.App. 1994).

[34] Id. at 708 & 712.

[35] Id. at 708.

[36] Id.

[37] 469 N.E.2d at 1198.

[38] Id.

[39] Id.

[40] Id. at 1200.

The court further noted factual evidence that Williams' sales personnel were required to elicit detailed information from customers and submit this information to Master.[41] Due to these various procedures, Williams's "sales personnel could not sell Master's products without first consulting Master."[42] The court concluded that, "Taken as a whole, there was substantial evidence from which the trial court could reasonably infer the existence of a marketing plan or system. The trial court correctly found the agreement to be a franchise."[43]

In *Hoosier Penn Oil Co. v. Ashland Oil Co.*,[44] the District Court denied a preliminary injunction seeking to prevent the putative franchisor from terminating its contract with the putative franchisee to distribute Valvoline Oil, in contravention of the law prohibiting termination of a franchise without cause.[45] As an initial matter, the Seventh Circuit considered if there was sufficient evidence to find that a franchise agreement existed between Hoosier, the putative franchisee, and Ashland, the putative franchisor.[46] In making this determination, the Seventh Circuit considered several factors, including the *Master Abrasives* factors in reaching the conclusion that there was no marketing plan.[47] The Seventh Circuit observed that the agreement between the parties "set out a number of details regarding Hoosier's obligation to purchase Valvoline oil, promote the sale of Valvoline products, and cooperate in Valvoline's promotional campaigns."[48] Specifically, the following were contained in the agreement:

- designation of the primary sales area;
- minimum yearly gallonage purchase requirement;
- Hoosier was to use its best efforts to promote sales;
- Hoosier was to cooperate with and use Valvoline promotional programs; and
- Valvoline was to approve advertising for its products.[49]

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[41] Id.

[42] Id.

[43] Id.

[44] 934 F.2d 882 (7th Cir. 1991).

[45] Hoosier, 934 F.2d at 882-84.

[46] Id. at 884.

[47] Id. at 885-86.

[48] Id. at 882.

[49] Id. at 885.

Despite these contractual mandates, the court found that as there was no prescribed marketing plan, and thus no franchise existed.[50] In support of its decision, the Seventh Circuit emphasized the following facts:

- "Ashland had no control over who Hoosier hired as sales employees";
- "the sales training offered to Hoosier employees by Ashland was not mandatory . . . Hoosier used it only when convenient";
- "although there where minimum gallonage purchase requirements, Ashland did not impose a sales quota"; and
- "Ashland had no control over what Hoosier's employees emphasized to purchasers, and did not tell Hoosier which customers to sell to."[51]

In *Horner v. Tilton and Mailboxes and Parcel Depot, Inc.*,[52] Horner, the putative franchisee, filed suit against Mailboxes, the putative franchisor, for breach of contract.[53] Mailboxes, in turn, filed a motion to dismiss for lack of proper venue based on the forum-selection clause contained in the agreement.[54] Horner argued that the forum-selection clause contravened the statutory prohibition against such clauses.[55] The trial court found that a franchise did not exist, and, therefore, the forum-selection clause was valid.[56] Accordingly, the trial court granted Mailboxes motion to dismiss and Horner appealed.[57] The Indiana Court of Appeals noted that pursuant to the parties' agreement, Mailboxes offered advice, provided consulting and support services, and obtained the necessary equipment and supplies.[58] In exchange, Horner agreed to conform to all specifications relating to the licensed trademarks and to open the store in the geographical area set forth in the license agreement.[59] As to the geographical restriction, the court stated, "The specification of geographical location in the agreement was used only in defining limits of the license granted to the Horners by Mailboxes

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[50] Id. at 885-86.

[51] Id. at 885.

[52] 650 N.E.2d 759 (Ind.Ct.App. 1995).

[53] Horner, 650 N.E.2d at 761.

[54] Id.

[55] Id.

[56] Id.

[57] Id. at 760-61.

[58] Id. at 761.

[59] Id. at 762.

for using Mailboxes' products."[60] The court ruled that "Pursuant to the agreement, Mailboxes did not retain any rights of control, training, or approval with regard to employees of the Horners' business, except the right to require that the Horners' employees be instructed how to protect Mailboxes' trademark and license, therefore, the agreement did not create a franchise . . . ."[61]

RWJ Cos. v. Equilon Enters.,[62] decided in the United States District Court for the Southern District of Indiana, addressed this issue of whether a franchise existed. In *RWJ*, the putative franchisee, RWJ, sought a preliminary injunction preventing the termination of its contracts with the putative franchisor, Shell. In deciding the preliminary injunction, the court looked at the likelihood of success on the merits.[63] The court found that RWJ may be able to establish that it operated "under a marketing plan or system prescribed in substantial part by a franchisor."[64] This decision was based in large part on evidence of Shell's control of the fuel prices. "Price is perhaps the most fundamental aspect of a marketing plan."[65] The evidence also showed that Shell prescribed "elaborate standards for MSO operators like RWJ governing every aspect of the filling station operation, from the lettering of signs and employee uniforms to the trimming of grass and shrubbery and the painting of the curbs, and whether customers must pre-pay and which credit cards they may use."[66] The court concluded by noting, "The evidence in this case shows that [Equilon] retained extensive control over the marketing of fuel and every aspect of the filling station operation, as well as substantial control over the marketing of convenience store products and services."[67]

2. Franchisee's Business Identified with Franchisor

I.C. §23-2-2.5-l(a)(2) requires that:

> The operation of the franchisee's business pursuant to such a plan is substantially associated with the franchisor's trademark, servicemark, tradename, logo type, advertising, or other commercial symbol designating the franchisor or its affiliate.[68]

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[60] Id.

[61] Id.

[62] 2005 WL 3544295 (S.D. Ind. 2005)

[63] Id. at *1.

[64] Id. at *4.

[65] Id. (quoting Petereit v. S.B. Thomas, Inc., 63 F.3d 1169, 1181 (2nd Cir. 1995)).

[66] Id. at *4.

[67] Id.

[68] I.C. 23-2-2.5-l(a)(2).

While subsection (1) deals with the actual connection between the franchisee's business and the franchisor, subsection (2) further distinguishes franchise contracts from other commercial contracts by requiring an objectively recognizable association. This prong of the franchise test is also highly fact-sensitive. The general rule is that “distribution of products or services covered by [the franchisor’s] trademark [is] sufficient to satisfy the substantial association requirement.[69]

Courts have taken two approaches in applying subsection (2). First, diversity of business operations is an important factor. In *Hoosier Penn*, the plaintiff sold several brands of oil. It contended that its "business under Valvoline's prescribed marketing plan was substantially associated with Valvoline's trade indicia."[70] The court agreed, but ruled against Hoosier Penn primarily because only ten percent (10%) of its sales involved defendant's product.[71] Second, if this low volume problem is absent, then this requirement is easy to satisfy. In *Master Abrasives*, "the distribution of products or services covered by [the franchisor's] trademark" satisfied the substantial association requirement.[72] In *Wright-Moore*, the agreement prohibited the plaintiff from using the defendant's name or trademark, but the court found that because defendant provided advertising materials with its trademark, subsection (2) was satisfied.[73]

3. Franchise Fee

I.C. §23-2-2.5-l(a)(3) requires that:

> The person granted the right to engage in this business is required to pay a franchise fee.[74]

The statute further defines a "franchise fee" as "any fee that a franchisee is required to pay directly or <u>indirectly</u> for the right to conduct a business to sell...”[75] (emphasis added). At first glance, this provision seems straightforward. However, reference to indirect fees renders subsection (3) difficult to apply. This language allows plaintiffs to show franchise consideration and turn what both parties likely believed, and indeed intended, to be a simple sales or services agreement into a franchise contract whenever a dispute arises.

The Seventh Circuit’s detailed analysis in *Wright-Moore* of the indirect fee issue focuses on the purpose behind the indirect fee rule. The *Wright-Moore* court's survey of the franchise

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[69] Wright-Moore, 908 F.2d at 135, n. 8 (quoting Master Abrasives, 469 N.E.2d at 1199).

[70] Hoosier Penn, 934 F.2d at 886.

[71] Id.

[72] Master-Abrasives, 469 N.E.2d at 1199.

[73] Wright-Moore, 908 F.2d at 135.

[74] I.C. §23-2-2.5-1(a)(3).

[75] I.C. §23-2-2.5-1(l).

laws of other states as well as commentaries on franchise law convinced the Seventh Circuit that Indiana's franchise statutes should be interpreted in light of the policy of protecting "franchisees who have unequal bargaining power."[76] The Seventh Circuit then noted that "the general policy behind franchise laws is particularly helpful in delineating the scope of the franchise fee requirement."[77] The *Wright-Moore* court then searched for a narrower policy that would support the formulation of a test to be applied specifically to the indirect fee issue and concluded that:

> The franchisor (supplier) may be able to change the terms for the worse after the franchisee (dealer) has invested much of its capital in the firm specific promotion, training, design and other features. Once the dealer is locked into the supplier, the supplier may seek to extract where an economist would call a quasi-rent." *Fleet Wholesale Supply v. Remington Arms Seal*. . . . The reason for the franchise fee requirement, in this light, is to ensure that only those entities that have made a firm specific investment are protected under the franchise law; where there is no investment, there is no fear of inequality of bargaining power.[78]

From this reasoning, the court established the rule that when dealers allege that a franchise fee was paid, they must prove that an unrecoverable investment was made in the business associated with the dealership.[79] Applying this task, the *Wright-Moore* court made three specific findings. First, while payment for goods supplies the consideration only for a sales contract,[80] a dealer's excess inventory caused by the supplier's terms — minimum purchase requirements, unreasonable sales quotes — can constitute an indirect franchise fee.[81] Second, cost incurred in training may also be an indirect fee if product specific that it amounts to an unrecoverable investment.[82] Third, ordinary business expenses incurred to deal with the supplier do not constitute an indirect franchise fee.[83]

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[76] Wright-Moore, 908 F.2d at 135.

[77] Id.

[78] Id. at 135-136.

[79] Id. at 136.

[80] The statute expressly excludes "The purchase or agreement to purchase goods at a bona fide wholesale price "as a franchise fee. I.C. §23-2-2.5-l(i)(3).

[81] Wright-Moore, 908 F.2d at 136. Here, the court relied upon other state statutes and judicial opinions to reach this result: Illinois' franchise statute states that "an indirect franchise fee . . . is present despite the bona fide wholesale or retail price exceptions if the buyer is required to purchase a quantity of goods so unreasonably large that such goods may not be resold within a reasonable time," Ill.Rey.Stat. §1703(14); the Minnesota courts have ruled that excess inventory can constitute an indirect franchise fee. *See,* American Parts System. Inc. v. T & T Automotive, Inc., 1984 Bus. Franchise Guide (CCH) 58262 (Minn.App. 1984).

[82] Wright-Moore, 908 F.2d at 136.

[83] Id.

Applying the *Wright-Moore* factors, the Indiana Court of Appeals has determined that an indirect fee is paid when the franchisee makes an investment which is:

1. Mandatory;
2. unrecoverable;
3. firm-specific; and
4. for the right to conduct a business to sell, resell, or distribute goods, services, or franchises under a contract agreement.[84]

Using this test, the following have been found to be indirect franchise fees:

- the cost of required excess inventory, as long as the quantity of goods is so unreasonably large as to be illiquid[85];
- highly firm-specific training which is not transferable to other products or services[86]; and
- discount rates on services provided to the franchisor[87];

However, application of this test has led Indiana courts to find that the following *do not* constitute indirect franchise fees:

- ordinary business expenses[88];
- agreements to enter into subcontracts for installation and maintenance lower than the franchisor's product[89];
- performance of subcontract work for the franchisor at a price lower than the franchisor charges its customers[90];
- performance of installation and service work in accordance with the franchisor's specifications[91];

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[84] Best Distrib. Co., Inc. v. Seyfert Foods, Inc., 714 N.E.2d 1196, 1201 (Ind. Ct. App. 1999). A Petition for Transfer was granted; therefore, this opinion was automatically vacated. However, the parties filed a "Report of Settlement" and thereby dismissed the appeal. This opinion, however, is still vacated but cited herein for reference purposes.

[85] Wright-Moore, 908 F.2d at 136, n. 8.

[86] Id.

[87] Communications Maint., Inc. v. Motorola, Inc., 761 F.2d 1202, 1206 (7th Cir. 1985).

[88] Best Distrib. Co., 714 N.E.2d at 1201.

[89] Communications Maint., Inc., 761 F.2d at 1206.

[90] Id.

- payment when receipt of the franchise is not conditioned on the payment[92];
- payment of wholesale goods at a price equal to that paid by other customers and purchasers of the same goods [93]; and
- payments made or discounts given to entities or persons other than the franchisor.[94]

4. Statutory Elements of Franchise Contract Conclusive

If the three statutory requirements are satisfied, then the parties' agreement is a franchise contract; end of inquiry. It does not matter if the written instrument expressly and emphatically purports to be another type of commercial agreement, if the parties indeed refer to the agreement by another title, or if the parties intended to enter into another type of contract.

This definitional conclusiveness can lead to results contrary to the protective purpose of the statutes. In *Wright-Moore*, the dealer was a large national distributor and the defendant supplier argued that the plaintiff did "not intuitively match the type of entity the Indiana legislature envisioned when writing the statute" but rather it was "invoking the image of a mom and pop franchisee" when it really had "equal bargaining power" and, therefore, did not bear any of "the hallmarks of a franchisee."[95] The court found this argument to have some merit, but dismissed it, noting that the Indiana legislature decided the "hallmarks of a franchisee . . . through its three statutory requirements."[96]

C. Application of Indiana Franchise Statutes

If the statutory definition of a franchise contract is satisfied, then the Franchise Statutes govern the agreement if "the offeree or franchisee is an Indiana resident" or "the franchised business. . .will be or is operated in Indiana."[97] Notice the legislature's second protective purpose — to protect insiders from outsiders; if an Indiana based franchisor makes offers in other states, it is free to bargain from a position of strength.[98] For the franchise statutes to be effective, Indiana courts must acquire personal jurisdiction over foreign franchisors and Indiana law must apply to contracts between Indiana citizens and foreign entities.

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[91] Id.

[92] Lafayette Beverage Distrib., Inc. v. Anheuser-Bush, Ind., 545 F.Supp. 1137, 1150-51 (N.D. Ind. 1982).

[93] McLane v. Pizza King, No. S 356-86, 1987 WL 92061, at *9 (Ind. Super. Sept. 4, 1987).

[94] Implement Serv., Inc. v. Tecumseh Prod. Co., 726 F.Supp. 1171, 1178 (S.D. Ind. 1989).

[95] Wright-Moore, 908 F.2d at 134.

[96] Id.

[97] I.C. §23-2-2.5-2 (a) (b).

[98] However, similar franchise statutes are common throughout the country. *See,* 12 G. Flickman, Business Organization: Franchising (1974).

1. Jurisdiction

Indiana's franchise statutes possess two mechanisms for securing personal jurisdiction over franchisors. First, subject to certain exemptions, a franchisor must register with the Indiana Securities Commissioner in order to offer to sell franchises in Indiana.[99] Upon such registration, the franchisor must give "an irrevocable consent appointing the Secretary of State . . . to receive service of any lawful process in any non-criminal suit."[100] Second, if any person engages in conduct prohibited by the statute and there is no other means of obtaining personal jurisdiction, then that conduct is deemed to be the equivalent of appointing the Secretary of State to receive service of process.[101] These provisions give Indiana very long arms, indeed.

2. Choice of Law

Indiana contract law recognizes the right of parties to bargain and contract as to which state's substantive law will govern their relationship.[102] Of course, this freedom to contract based on bargaining power undermines the protective goal of the Indiana Franchise Statutes. Recognizing this contradiction, the court in *Wright-Moore* voided a choice of law provision in a franchise contract because it had the effect of circumventing Indiana franchise law, thereby depriving the franchisee of its statutory protection.[103]

Accordingly, the court applied the Restatement's "most intimate contacts test" to the contract's provision that chose New York law as the governing law.[104] Under the *Wright-Moore* court's analysis of this test, a choice of law provision in a franchise contract is valid unless application of the chosen law would be "contrary to a fundamental policy of a state which has a materially greater interest" in the litigation.[105] The court found a "fundamental policy" of Indiana in the statute's prohibition against any contractual terms which purport to relieve a franchisor from liability imposed by the statute or limit litigation for breach of the agreement.[106]

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[99] *See*, I.C. §23-2-2.5-9.

[100] I.C. §23-2-2.5-24.

[101] I.C. 23-2-2.5-38.

[102] *See*, Moll v. South Central Solar Systems. Inc., 419 N.E.2d 154, 162 (Ind.Ct.App. 1928)

[103] Wright-Moore, 908 F.2d at 132-134.

[104] As a federal court with diversity jurisdiction, the Seventh Circuit is bound to apply Indiana's law of conflicts. Indiana has long applied the intimate contacts test to choice of law issues in contract cases; this test states that "the court will consider all acts of the parties touching the transaction in relation to the several states involved and will apply [the law] of that state with which the facts are in most intimate contact." W.H. Barber v. Hughes. 63 N.E.2d 417, 423 (Ind. 1945).

[105] Wright-Moore, 908 F.2d at 132.

[106] The court found this policy interest in I.C. §23-2-2.7-1, which makes unlawful any contract term that requires "the franchisee to prospectively assert to a release, assignment, novation, waiver, or estoppel which purports to relieve any person from liability imposed by this Chapter," I.C. §23-2-2.7-1(5), or that limits "litigation for breach of the agreement in any manner whatsoever," I.C. §23-2-2.7-1(10). Thus, Indiana's public policy interest is not based on substantive terms but rather the procedural terms that prohibit waiver. Other, jurisdictions have relied upon *Wright-Moore* to uphold choice of law provisions where the state's franchise statutes gave franchisee substantial protection but no anti-waiver protection. *See*, Electrical and Magaeto Service Co. v. AMBC Intern., 745 F.Supp. 1501 (W.D. Mo. 1990).

The court further reasoned that no choice of law provision could be permitted to undermine Indiana's public policy of not allowing waiver of the franchisee's statutory protection.[107] The court, thus, concluded that Indiana had a "materially greater interest" in the litigation than New York because New York's only connection to the contract was that the defendant franchisor was incorporated under New York law.[108]

Given the reasoning and holding in *Wright-Moore*, any provision of a franchise contract with an Indiana citizen as the franchisee that purports to apply the law of another state will be contrary to Indiana public policy and will be voided as long as Indiana has a greater interest in the action than the other state. This would normally be true if the franchise business is located in Indiana, but if an Indiana franchisee operates a franchise in another state, particularly the state of the chosen law, then it may well lose its statutory protection to a choice of law term in a contract.

III.

STRUCTURE AND TERMS OF INDIANA'S FRANCHISE STATUTES

If a commercial agreement constitutes a "franchise contract" under Indiana law, the parties are subject to personal jurisdiction in Indiana, and Indiana law governs the agreement, then the Indiana Franchise's Act (Chapter 2.5) and the Indiana Deceptive Franchise Practices Act (Chapter 2.7) greatly infringe upon the freedom of commercial parties to voluntarily contract through bargaining. Analytically, these two laws are separate and distinct, but, combined, their various and complex terms establish a regulatory scheme that governs the contracting process from beginning to end. The scheme controls the offer, negotiation, substantive content, performance and termination of franchise contracts.

A. The Offer of a Franchise Contract

Governing offers to contract by statute is a difficult task because the common law recognizes so many acceptable modes of offering and accepting a contract, but one type of offer is amenable to statutory regulation — the advertisement. Under Chapter 2.5, it is unlawful to publish an "advertisement offering a franchise" if the Commissioner finds it to contain false or misleading information.[109]

B. The Negotiation of a Franchise Contract

The purpose of Chapter 2.5 is to provide potential franchisees with both abundant and accurate information during their negotiations with franchisors. This is accomplished in two ways: first, an administrative agency forces franchisors to disclose certain information; second, the statute recreates a private cause of action for franchisees victimized by a franchisor's misrepresentation or fraud.

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[107] Wright-Moore, 908 F.2d at 132.

[108] Id. at 133.

[109] I.C. §23-2-2.5-26.

1. Disclosure of Information

Chapter 2.5 subjects franchisors to an elaborate registration and disclosure scheme designed to extract relevant information on their business operations. If not exempt, franchisors must register with the Indiana Securities Commissioner and file a disclosure statement with the application for registration.[110] Even if exempted,[111] franchisors must make a written disclosure to offerees “at least ten (10) days prior to the receipt of any consideration."[112] Thus, franchisors must make extensive disclosures either directly to potential franchisors or indirectly through the registration procedure. The disclosure requirements are tailored to provide reliable information in order to afford a reasonable opportunity for the exercise of independent judgment on the part of parties, in connection with the issuance, barter, sale, purchase, transfer or disposition of franchises in Indiana.[113] Although failure to comply with the registration and disclosure requirements of the Act does not create a private cause of action absent a showing of fraud, deceit or misrepresentation,[114] such conduct may be relevant to a determination of whether franchise fraud was committed for purposes of Section 27 of the Franchise Act, Ind. Code § 23-2-2.5-27.

The statute forces franchisors to divulge several pieces of information useful to the offeree. First, franchisors must disclose their business experience as a franchisor, the length of time operating as a franchisor, the number of franchises granted, and the type of franchises granted.[115] Second, franchisors must disclose their litigation history, both criminal and civil.[116] Third, they must disclose detailed financial data; if required to register, franchisors must file balance sheets with the commissioner[117]; otherwise, they must disclose to the potential franchisee any data that support representations as to estimated profits.[118] Fourth, franchisors must provide the details of any financing agreements relevant to the negotiations.[119]

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[110] I.C §23-2-2.5-10.5.

[111] I.C. §23-2-2.5-3 exempts certain franchisors from registering with, and being supervised by, the Indiana Securities Commissioner. Franchisors are exempted either because of their large net worth or extensive sales activities, I.C. §23-2-2.5-3(a)(b). As Professor Bepko notes this exemption appears to be based on the following presumptions: Large franchises have sufficient assets and stability to pay claims made by franchisees, and; these large franchisors may be so well known that there is little potential for misrepresentation. Bepko at 152.

[112] I.C. §23-2-2.5-3(c).

[113] I.C. §23-2-2.5-27.

[114] *See,* Continental Basketball Ass’n, 669 N.E.2d at 137; Hardee’s of Maumell, Arkansas, Inc. v. Hardee’s Food Systems, Inc., 31 F.3d 573, 577 (7th Cir.1994)

[115] I.C. §23-2-2.5-3(c)(4); 16 C.F.R. §436.5(a)

[116] 16 C.F.R. §436.5(c). This applies only to franchisors required to register with the Commissioner.

[117] 16 C.F.R. §436.5(g) (h) (i).

[118] I.C §23-2-2.5-3(c)(13).

[119] I.C. §23-2-2.5-3(c)(11).

Additionally, the statute requires franchisors to disclose information on specific terms common to franchise contracts. The franchisor must present a statement indicating whether the agreement will require the franchisee to purchase goods from the franchisor[120], and whether the franchisee is "limited in the goods or services he may offer to his customers."[121] The franchisor must indicate whether the "franchisee will receive an exclusive area or territory."[122] Franchisors must also provide a statement that explains the terms and facts of covenants not to compete.[123] Finally, and of great importance to offerees, franchisors must spell out specifically the "conditions under which the franchise agreement may be terminated, renewal refused, or repurchased"[124] and a statement of the obligation of the franchisee upon termination or expiration of the franchise.[125]

Thus, Chapter 2.5 provides potential franchisees with valuable information on the character of the offeror and a detailed explanation on the proposed agreement's position on terms typically important to franchisees.[126]

2. Misrepresentation and Fraud

In addition to providing potential franchisees with business information and an explanation of terms, the statute creates a private cause of action to guard against dishonesty and fraud on the part of the franchisor during negotiations:

> It is unlawful for any person in connection with the offer…of any franchise…directly or indirectly:
>
> (1) To employ any device, scheme or artifice to defraud;
>
> (2) To make any untrue statements of a material fact or to omit to state a material fact necessary in order to make the statements, in light of the circumstances under which they were made, not misleading; or

[120] I.C. §23-2-2.5-3(c)(9); i.e. 16 C.F.R. §436.5(h)

[121] For exempt franchisors, I.C. §23-2-2.5-3(10); *see also*, 16 C.F.R. §436.5(i).

[122] I.C. §23-2-2.5(c)(14); *see also*, 16 C.F.R. §436.5(l), for registered franchisors.

[123] 16 C.F.R. §436.5(o).

[124] I.C. §23-2-2.5-3(c)(8).

[125] *See*, 16 C.F.R. §436.5(q)

[126] This disclosure is typically made in the form of a Uniform Franchise Offering Circular (UFOC) that contains, in addition to three years of audited financial statements of the franchisor, material information about the business experience of the franchisor, initial investment and expenses, trademark rights, contractual obligations of the franchisor and franchisee, and other information, including statements of certain risks inherent in a franchise. In particular, the UFOC sets out specific format and disclosure requirements with respect to any earnings claim that a franchisor may elect to make to a prospective franchisee. In addition, the UFOC must include copies of all contracts a franchisee must sign in connection with the franchise (Information about the content of a UFOC may be found on the FTC's website at http://www.ftc.gov/bcp/franchise/netrule.htm).

(3) To engage in any act which operates or would operate as a fraud or deceit upon any person.[127]

If a franchisee prevails in an action brought under this provision, it can recover consequential damages, interest on the judgment at a rate of eight percent (8%), and, in some cases, reasonable attorney's fees.[128] The franchisee can bring an action against "every person who materially aids or abets" in an act violative of this provision.[129] This is an important allowance because it allows officers, managers and agents of the franchisor to be subjected to joint and several liability along with the corporate entity. The actions made unlawful under this section, and for which a private cause of action is recognized, have been collectively referred to by the Indiana courts as "franchise fraud."[130]

It is not clear whether the legislature intended this provision to be only a statutory replica of common law fraud, and, if so, what purpose it would serve. Professor Bepko observed that "in the past aggrieved franchisees have experienced some difficulties in proving a cause of action for traditional fraud and breach of contract. . .this section should aid. . .franchisees since it provides a new general vehicle for claims for abuses in franchise sales.[131] Initially, Indiana courts construed this prohibition as a "general anti-fraud provision," and, thus, required plaintiffs to satisfy the special pleading requirements associated with actions for fraud.[132]

However, in *Enservo*, the Indiana Supreme Court distinguished franchise fraud from "common law fraud," insofar as the requirement of "scienter"—i.e., "knowledge or reckless ignorance of the falsity" of a representation or, as stated in the Act, "not made honestly or in good faith."[133] Rejecting the opinions of the Indiana Court of Appeals in *Moll v. South Central Solar Systems*[134] and *Master Abrasives Corporation v. Williams*,[135] Indiana's high court held that scienter is only an element of franchise fraud for actions brought under Section 27(1) (for employing "any device, scheme or artifice to defraud") but not with respect to actions under

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[127] I.C. §23-2-2.5-27. The statute of limitations for this cause of action is three years beginning at the time plaintiff discovered the facts constituting a violation. I.C. §23-22.5-30.

[128] I.C. §23-2-2.5-28.

[129] I.C. §23-2-2.5-29.

[130] *See, e.g.*, Continental Basketball Association, 669 N.E.2d at 137; Enservco, Inc. v. Indiana Securities Division, 623 N.E.2d 416, 422-425 (Ind. 1993).

[131] Bepko at 153.

[132] *See,* Moll v. South Central Solar Systems, Inc., 419 N.E.2d 154, 162 (Ind.Ct.App. 1982). In Indiana, the elements of fraud are a material representation of past or existing facts, which are false, made with knowledge or reckless ignorance of falsity, which causes a reliance upon these representations, to the detriment of the person so relying. Whiteco. Properties, Inc. v. Theilbar, 467 N.E. 2d 433 (Ind. App. 1984).

[133] *See,* 623 N.E.2d at 421-425 and I.C. § 23-2-2.5-1(f).

[134] 419 N.E.2d at 162.

[135] 469 N.E.2d at 1196.

Section 27(2) (making "any untrue statements of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of circumstances under which they are made, not misleading") or Section 27(3) (engaging "in any act which operates or would operate as a fraud or deceit upon any person").[136]

The Indiana Supreme Court further noted that the "core elements of section 27(2) and (3) franchise fraud are therefore a statement or omission, materiality and falsity" with respect to a material fact.[137] Moreover, the court noted that sections 27(2) and (3) afford a private cause of action for "false prediction, promise or representation about the future" if the statements were not made honestly or in good faith,"[138] citing the Act's definition of "fraud" and deceit" as including:

> any misrepresentation in any manner of a material fact, *any promise or representation or prediction as to the future not made honestly or in good faith,* or the failure or omission to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading."[139]

While "franchise fraud" is not the equivalent of common law fraud, a plaintiff must still prove reasonable reliance on the statement, as courts have held that the Act "requires proof of reasonable reliance."[140] Two cases have explored the issue of reasonable reliance as requirement for proof of franchise fraud. In *Master Abrasive*, the franchisee took the position that "statements concerning profit potential and ease of earning back the investment are sufficient to support a finding of fraud."[141] The court disagreed, instead concluding that "[t]hese statements are mere opinion," which the franchisee's agents "had no right to rely thereupon."[142] The court noted that although "statements as to the profit potential of the franchise are not sufficient for a finding of fraud . . . statements about existing distributorships and their profitability will support such a finding."[143]

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[136] Enservco, 623 N.E.2d at 422- 425.

[137] Id. at 423.

[138] Id. at n.11.

[139] I.C. §23-2-2.5-1(f) (emphasis added).

[140] Hardee's of Maumelle, Arkansas, Inc. v. Hardee's Food Systems, Inc., 31 F.3d 573, 579 (7th Cir. 1994) (the Seventh Circuit noted, following lower Indiana courts).

[141] Master Abrasive, 469 N.E.2d at 1201.

[142] Id.

[143] Id.

At issue in *Hardee's* was the franchisor's statement regarding "the possibility of buying company-owned stores after developing the Maumelle site (the 'build one-buy one' policy)."[144] With respect to the "build one-buy one" policy, the district court found that the plaintiffs had not actually relied upon such a policy when deciding to buy the Maumelle store. In particular, the district court noted that the plaintiffs' business plan submitted to Hardee's did not mention a "build one-buy one" policy, but only requested more information on buying company-owned restaurants. The plaintiffs' application for financing also failed to reference a "build one-buy one" policy.[145] Thus, the court denied recovery under the act because Hardee's statements were "merely predictions or statements of opinion rather than material facts . . . ."[146] The Court of Appeals affirmed, noting that the "Plaintiff did not rely on Hardee's representations when entering the Maumelle transaction, the Plaintiff has failed to prove an essential element of a claim under the IFA, and we can affirm the district court's denial of relief on that ground alone."[147] The appellate court further agreed that "it would have been particularly unreasonable for [plaintiff] to rely on any of these representations since he had signed a licensing agreement containing an integration clause that [he], a lawyer, must have understood."[148] The integration clause in the licensing agreement stated:

> This agreement, the documents referred to herein, and the Exhibits attached hereto, if any, constitute the entire, full and complete agreement between LICENSOR and LICENSEE concerning the subject matter hereof, and supersede all prior agreements.[149]

Thus, the court emphasized that "[I]t is simply unreasonable to continue to rely on representations after stating in writing that you are not so relying."[150]

Likewise, Plaintiff franchisees may not rely upon claimed oral "misrepresentations" which are belied by the documents produced. [151]

C. The Terms of a Franchise Contract

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[144] Hardee's, 31 F.3d at 575.

[145] Id.

[146] Id. at 578.

[147] Id. at 579.

[148] Id. at 576.

[149] Id.

[150] Id.

[151] *See* Traders Ins. Co. v. Cassell, 56 N.E. 259, 260 (Ind.Ct.App. 1900)(insured is conclusively presumed to know contents of insurance policy); *Jarvis Drilling, inc. v. Midwest Oil Producing Co.*, 626 N.E.2d 821, 825-26 (Ind.Ct.App.1993) (party does not have right to rely on misrepresentation where statements were contradicted by documents plaintiff had access to); *Biberstine v. New York Blower Co.*, 625 N.E.2d 1308, 1316 (Ind.Ct.App.1993)(no right to rely on oral statements that were in direct contravention of terms of written agreement); *Roberts v. Agricredit Acceptance Corp.*, 764 N.E.2d 776, 779-80 (Ind.Ct.App.2002).

Chapter 2.7 controls the substantive terms of the franchise contract. This provision sets forth eleven provisions common to franchise contracts that shall be unenforceable and unlawful if contained in a contract with an Indiana citizen or a non-resident operating a franchise in Indiana.[152] These specific prohibitions protect franchisees in several ways.

First, the franchisee is protected against forced purchases, surprise price increases, and unexpected expenses. The contract cannot require the franchisee to buy goods or services exclusively from the franchisor, or sources designated by the franchisor, if goods or services of comparable quality are available elsewhere.[153] The contract also cannot permit the franchisor to increase prices on goods after-ordered by the franchisee.[154] Likewise, the contract cannot require the franchisee to participate in promotional campaigns at his own expense unless the terms specify the maximum expenditure related to gross sales.[155]

Second, the franchisee's competitive position in the market is protected by the statute. The franchisor cannot include a term which allows it to compete with the franchisee within a reasonable area.[156] Also, the contract cannot contain a covenant not to compete that limits the franchisee's right to compete against the franchisor for a period greater than three years after termination of the contract.[157]

Third, the contract cannot require the franchisee to waive any of the Chapter's protections,[158] or "limit litigation for breach of the agreement in any manner whatsoever."[159]

Fourth, the contract cannot contain a term which allows "substantial modification of the franchise agreement by the franchisor without the consent in writing of the franchisee.[160] In *Montgomery v. Amoco Oil Co.*,[161] the franchisee alleged that the franchisor violated this provision by unilaterally imposing a credit card fee. The Seventh Circuit disposed of this case on the grounds that the imposition of the fee was not pursuant to a contract term that expressly allowed unilateral modification. This implies that if a franchisor refrains from insisting on terms allowing unilateral modification of the party's commercial relationship and instead simply acts

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[152] I.C. §23-2-2.7-1.

[153] I.C. §23-2-2.7-1(1).

[154] I.C. §23-2-2.7-1(6).

[155] I.C §23-2-2.7-1(11).

[156] I.C. §23-2-2.7-1(2).

[157] I.C. §23-2-2.7-1(9).

[158] I.C. §23-2-2.7-1(5).

[159] I.C §23-2-2.7-1(10).

[160] I.C. §23-2-2.7-1(3).

[161] 804 F.2d at 1000.

unilaterally by imposing such terms, then no violation occurs. This reasoning undermines several of the protective prohibitions set forth in this statute; for example, the franchisor could omit a term allowing it to compete with the franchise and, instead, just do it. However, as illustrated below, the Seventh Circuit has retreated from this reasoning.

If a franchise contract contains any of the enumerated terms, the franchisee may bring suit either for damages or to reform the franchise agreement.[162] Thus, in the interest of protecting the franchisee, the statute makes certain terms unbargainable and, if any agreement contains a forbidden term, a private cause of action arises in favor of the franchisee.

D. The Performance of A Franchise Contract

Chapter 2.7 continues to protect the franchisee during performance of the contract. This provision goes to the heart of the legislature's protective purpose. As the *Wright-Moore* court emphasized, the franchisee is typically vulnerable during the performance of the contract because his large firm-specific investment gives the franchisor great leverage. I.C. §23-2-2.7-2 makes unlawful specific acts that franchisors, given their superior power, might well be tempted to engage in during the performance of the contract. Many of these unlawful performances resemble the type of terms banned by I.C. §23-2-2.7-1.

First, the statute deals with the potential for coercion during performance of the franchise contract. It is unlawful for a franchisor to coerce the franchisee to accept delivery of goods that are not voluntarily ordered, required by the agreement, or necessary to the operation of the franchise.[163] Similarly, the franchisor cannot coerce the franchisee into accepting accessories not included in the base price of goods[164], or require marketing expenditures not specified in the contract.[165] Also, it is unlawful for the franchisor to obtain a different agreement from the franchisee by "threatening to cancel or fail to renew" any existing agreement.[166] Second, the statute protects the franchisee from direct competition by the franchisor. It is unlawful for the franchisor to establish a competing business within an exclusive geographical market granted to the franchisee, or, if no exclusive territory is identified, to "[compete] unfairly with the franchisee within a reasonable area."[167] Third, the statutes render breaches by the franchisor statutory violations. The franchisor's non-performance in "[r]efusing or failing to deliver in reasonable quantities and within a reasonable time after receipt of an order" is an unlawful practice.[168] Also, it is unlawful for the franchisor to raise the

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[162] I.C. §23-2-2.7-4.

[163] I.C. §23-2-2.7-2(1) (i).

[164] I.C. §23-2-2.7-2(1) (ii).

[165] I.C. §23-2-2.7-2(1) (iii).

[166] I.C. §23-2-2.7-2(1)(iv).

[167] I.C. §23-2-2.7-2(4).

[168] I.C. §23-2-2.7-2(2).

price of goods once ordered from a price list.[169] Additionally, the statute prohibits "using deceptive advertising or engaging in deceptive acts in connection with the franchise or franchisor's business."[170]

Fourth, the statute contains a catch-all provision that makes it unlawful for the franchisor to "unreasonably [fail] or [refuse] to comply with any terms of a franchise agreement."[171]

Lastly, a franchisor commits a statutory violation by "discriminating unfairly among its franchisees. . . ."[172] This is the most interesting, problematic, and litigated provision of I.C. §23-2-2.7-2. At first glance, it is not apparent how this discrimination provision relates to the protective purpose of the franchise statutes. Here, instead of focusing on the disparity of bargaining power between the parties and preventing direct abuse of the franchisee at the hands of the franchisor, the statute creates a provision akin to an equal protection clause that governs the manner by which the franchisor deals with all of its franchisees, many, indeed most, of which are not Indiana citizens entitled to protection under the statute. Perhaps the statute's goal is to prevent the franchisor from playing one franchisee against the other to extract favorable terms, but the other statutory provisions would seem adequate to serve this goal -- for example, the provision on coercion and competition. Read another way, the statute might aim at prohibiting unfair treatment and only use the franchisor's dealings with other franchisees to establish a standard of fairness. Furthermore, this provision suffers from vagueness; the verb "discriminate" establishes a broad mandate not easily carried out by courts, and the adverb "unfairly" creates an open standard subject to a multitude of interpretations.

The courts have defined and confined this provision by analogizing to other laws dealing with the difficult subject of discrimination. To apply the discrimination provision, the courts have broken it down into its constituent components — "discrimination" and "unfairly." First, in *Canada Dry. Corp. v. Nehi Beverage Co., Inc.*, the court developed a standard by which to identify discrimination among franchisees by turning to federal law that prohibits freight rate discrimination and employment discrimination; the court noted that legal discrimination of any type refers to discrimination among persons "substantially similar."[173] Thus, the court concluded that:

> Discrimination among franchisees means that as between two or more similarly situated franchisees, and under similar financial and marketing conditions, a franchisor engaged in less favorable treatment toward the discriminatee than other

[169] I.C. §23-2-2.7-2(7).

[170] I.C. §23-2-2.7-2(8).

[171] I.C. §23-2-2.7-2(5).

[172] Id.

[173] 723 F.2d 512, 521 (7th Cir. 1983).

> franchisees. Thus, proof of "discrimination" requires a showing of arbitrary disparate treatment among similarly situated individuals or entities.[174]

The breadth of this similarly situated requirement has proven to be a difficult obstacle for franchisees to clear. In *Canada Dry*, every franchisee of the defendant except for plaintiff had been allowed to participate in, and benefit from, a product promotion campaign. However, the court rejected the discrimination claims because "Nehi introduced no evidence of more favorable treatment of similar bottlers under similar marketing conditions."[175] Of course, the plaintiff did not know of this standard at the time and probably assumed, wrongly, that proof that, of the nine franchisees, only it was excluded from the program would suffice as proof of discrimination; moreover, even if it had notice of this standard, the franchisee would have had much difficulty in proving similarity of markets. In *Implement Services, Inc., v. Tecumseh Products Co.*, the franchisee alleged discrimination based on the fact that other franchisees were allowed to purchase from two sources, while it was restricted to only one. The court held that the plaintiff was not "geographically 'similarly situated'" to the other franchisees because they were located near state borders, and thus suffered no discrimination.[176] In *Wright-Moore,* the court denied the discrimination claim because the plaintiff was "the only true national distributor; all the other so-called national distributors only operated in smaller regions of the country. There is . . . no similarly situated distributor."[177] Hence, discrimination was impossible in this case.

Second, the courts have developed a standard by which to determine when a franchisee has been discriminated against "unfairly" by turning to the law of employment discrimination. In *Ford Motor Credit Co. v Garner*,[178] the court adopted the procedural standard for defining unfair discrimination commonly used in employment discrimination cases:

> The word unfairly is used…to modify the word discriminated, so that only discrimination which is not fair discrimination is actionable…an analogy can be found in employment discrimination cases, where the *McDonnell Douglass-Burdine* three-step paradigm is applied.[179]

Thus, unfair discrimination among franchisees is determined by procedure. First, the plaintiff must make a *prima facie* case of discrimination. As noted above, this is a great obstacle given the "similarly situated" requirement. Second, if the plaintiff makes this showing, then the burden shifts to the defendant to show a legitimate non-discriminatory reason for the

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[174] Id.

[175] Id. at 521-522.

[176] 726 F.Supp. 1171, 1181 (S.D. Ind. 1989).

[177] 908 F.2d at 139.

[178] 688 F.Supp. 435 (N.D. Ind. 1988).

[179] Id. at 445.

action, and "even bad reasons are good enough, so long as they are non-discriminatory."[180] If the defendant makes the showing, the burden shifts back to the Plaintiff to "prove that the proffered reason is pretextual, that a discrimination reason more likely motivated the employer."[181] In *Garner*, the franchisor's delay in enforcing a guarantee clause against the franchisee was found to be a discriminatory action. However, the court accepted the franchisor's claim that the discrimination was motivated by economic concerns and a lack of information on its part.

On its face, the non-discrimination provision of chapter 2.7 seems to offer franchisees much protection, but, as construed by the courts, this provision has not proven to be a great restraint on the franchisor's ability to deal with franchisees. To date, no franchisee has prevailed in a discrimination action; all but one, have been unable to prove any discrimination at all, and in *Garner* the plaintiff could not carry the heavy burden of proving that the proffered non-discriminatory reasons were pretextual. Given the court's definition of "discrimination and its placement of the burden of proof on the franchisee, this discrimination provision will have little effect on the performance of franchise contracts.

E. The Termination of the Franchise Contract

In Indiana, the common law permits the parties to bargain for terms specifying how and when the contract will terminate. However, premature, arbitrary, or unexpected termination of the franchise relationship is perhaps the greatest danger to franchisees arising from disparity of bargaining power. As noted earlier, the typical franchisee often incurs substantial debt and exposes life savings in order to make a large, firm-specific investment in the franchise. Thus, if the franchisor is permitted to mandate terms that give it broad termination powers, the franchisee is in constant danger of losing his investment before ample time in which to earn a return and is also placed at a disadvantage in dealing with the franchisor, who holds the franchisee's fate in its hands. Chapter 2.7 seeks to protect the franchisee from termination by requiring notice of termination and controlling the type of termination terms that are lawful.

1. Notice of Termination

Chapter 2.7 states that:

> Unless otherwise provided in the agreement, any termination of a franchise or election not to renew a franchise must be made on at least ninety (90) days notice.[182] (emphasis added).

Read literally, this provision gives franchisees only limited protection against unexpected terminations, and the courts have read this language literally. In *Snihurowycz v. AAMCO Transmission, Inc.*, the agreement allowed AAMCO to terminate the contract upon

[180] Id.

[181] Id.

[182] I.C. §23-2-2.7-3.

written notice.[183] The court found for AAMCO because "the agreement did 'otherwise provide' for termination, and AAMCO was not required to give . . . 90 days' notice."[184] Thus, if a franchisor uses its bargaining power to obtain a term allowing immediate termination, then the agreement does otherwise provide for notice and the statute is inapplicable.

2. Unlawful Termination Terms

Chapter 2.7 sets forth two mandates concerning the termination of franchise contracts. First, the statute makes it unlawful for any franchise agreement to contain terms:

> Permitting unilateral termination of the franchise if such termination is without good cause or in bad faith. Good cause…includes any material violation of the franchise agreement.[185]

Second, it is unlawful for any franchise contract to contain a term:

> Permitting the franchisor to fail to renew a franchise without good cause or in bad faith. This chapter shall not prohibit a franchise agreement from providing that the agreement is not renewable upon expiration….[186]

The first question raised by these statutory prohibitions is the same one that faced the court in *Montgomery v. Amoco Oil Co.*: is an express contract term needed to create a violation of I.C. §23-2-2.7-1? In that case, the franchisee argued that the defendant had violated the prohibition against terms allowing unilateral modification without the franchisee's written consent. The court found for the defendant, stressing that there was no contract term allowing unilateral modification; the franchisor had just acted unilaterally.[187] However, in *Wright-Moore*, there was no agreed upon term "permitting unilateral termination . . . without good cause," but the Seventh Circuit nonetheless found for the franchisee where the franchisor had unilaterally terminated.[188] Here, the franchisor gave oral assurances that the agreement would be renewed, but even this does not square *Wright-Moore* with *Montgomery*. The oral representations would support an action for breach of contract in *Wright-Moore*, but not for a violation of I.C. §23-2-2.7-1, according to the reasoning in *Montgomery*. Like in *Montgomery*, there was no term permitting unilateral action in *Wright-Moore*; the defendant simply acted unilaterally. Thus, this retreat from the reasoning of the *Montgomery* court has given the statutory prohibition on certain terms some bite.

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[183] 418 N.E.2d 1190 (Ind.Ct.App. 1981).

[184] Id. at 1192.

[185] I.C. 23-2-2.7-l (7).

[186] I.C. §23-2-2.7-l (8).

[187] 804 F.2d at 1004.

[188] 908 F.2d at 139.

In *Wright-Moore*, the plaintiff claimed both that the franchisor had unilaterally terminated in bad faith and without good cause. The court found the evidence insufficient to support the allegation of bad faith, but did find the termination to be without good cause. The defendant argued that it terminated solely on account of economic reasons. With no decision by Indiana courts finding good cause and no guidance from legislative history, the court resolved the issue of whether "good cause also includes termination for the benefit of the franchisor's balance sheet"[189] by looking to interpretations of franchise laws in other jurisdictions and concluding that to hold that a franchisor's economic decisions constitute good cause would contravene the protective purpose of the statute, because a franchisor could apply an economic justification to virtually any decision it made to terminate the business of a franchisee.[190]

IV.

CONCLUSION

Legislative choices regarding the franchise demonstrate the extent to which the law and commerce are willing to rely upon the principle of the freedom to contract as a means for ordering legal relations in an equitable and economically stable fashion. However, the Indiana franchise statutes can be problematic to courts required to interpret them. The statutes articulate only vague standards of behavior for complex transactions, leaving the courts to provide additional necessary details. Furthermore, Indiana does not complement its laws with legislative history, and, finally, the statutes' substantive terms create diversity jurisdiction, often requiring the federal courts to interpret Indiana law with little guidance from Indiana authority. Consequently, courts often encounter ambiguity in the Indiana franchise statutes.

Since the General Assembly enacted the Indiana Franchise Act and the Indiana Deceptive Franchise Practices Act in 1975, a small but formative body of case law explaining and applying the acts has emerged. By abridging and carefully circumscribing the freedom to contract, the legislature has established a framework to order the broad, long-term, vertical economic relationship between franchisor and franchisee. Despite their characteristic vagueness, the franchise statutes clearly reflect the legislature's effort to balance the community's interest in contractual freedom with the need to regulate the franchise relationship in the interest of fairness and efficiency, and, for the most part, courts have interpreted and applied the statutory terms accordingly.

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[189] Id. at 137.

[190] Id.