

4-1-2015

Franchise and Contract Asymmetry: A Common Trans-Atlantic Agenda?

Tibor Tajti

Central European University

Recommended Citation

Tibor Tajti, *Franchise and Contract Asymmetry: A Common Trans-Atlantic Agenda?*, 37 Loy. L.A. Int'l & Comp. L. Rev. 245 ().
Available at: <http://digitalcommons.lmu.edu/ilr/vol37/iss2/4>

This Article is brought to you for free and open access by the Law Reviews at Digital Commons @ Loyola Marymount University and Loyola Law School. It has been accepted for inclusion in Loyola of Los Angeles International and Comparative Law Review by an authorized administrator of Digital Commons @ Loyola Marymount University and Loyola Law School. For more information, please contact digitalcommons@lmu.edu.

Franchise and Contract Asymmetry: A Common Trans-Atlantic Agenda?

PROF. TIBOR TAJTI (THAYTHY)¹ ©

Abstract: Normative legal theories, no matter whether pluralist or monist, tend to formulate what the law should be. Based on what values, either on a purely theoretical plane, or based on a single or a few paradigm contracts – the contours of which seem to be most solidified according to common opinion – like sales contracts. They fail, however, to answer the query about what happens in cases of newer-generation contracts, such as franchise contracts, one of the quintessential features of which is information and strategic asymmetry. The basic premise of this article is that given the European popularity of business format franchise originating in the United States (U.S.), asymmetry is a common concern on both sides of the Atlantic. Moreover, as the franchise regulation is in its inception in Europe, the more advanced-United States should be relied upon. The main argument of the paper is that asymmetry is a sine qua non feature of franchise that should be taken into account as a value by normative legal theories. It is also claimed that asymmetry could be deconstructed and applied mutatis mutandis to other types of contracts as well.

List of Abbreviations:

BFA	-	British Franchise Association
DCFR	-	Draft Common Frame of Reference (Europe)
EU	-	European Union
FTC	-	Federal Trade Commission (U.S.)
IFA	-	International Franchise Association
UCC	-	Uniform Commercial Code (U.S.)
UNIDROIT	-	International Institute for the Unification of Private Law

Gillian K. Hadfield: “Franchising is a significant and problematic force in such areas as antitrust, product liability, intellectual property, securities and agency law. Most im-

1. Professor of law and Chair of the International Business Law Program at Central European University, Legal Studies Department, Budapest, Hungary (< <http://www.ceu.hu> >). Contact email < tajtit@ceu.edu >; telephone (CEU office): +36 1 327 3275. The author would like to express his gratitude to Alexandra Horvathova and Patricia Živković for help in research related to this article. The views expressed herein are entirely attributable to the author and they do not necessarily reflect the position of CEU.

portantly, however, franchising is problematic for contract law. . . .”

[Albeit, especially in the United States, it has become] increasingly regulated . . . the heart of franchising’s legal structure is still contract.” (Emphasis added).²

I. INTRODUCTION: WHY FOCUS ON CONTRACT ASYMMETRY?

A. *The Subjective Agenda or why I have become interested in Contract Asymmetry*

Even if unrevealed, concrete reasons tend to explain the interest of scholars in the topics they choose to explore. In the case of the author of this paper, two such reasons and the resulting ramifications will be shown in this paper. The primary reason was a Polish high court case³ I came to read as a co-editor of one of the rare Continental European case law books in English.⁴ Being especially interested in the fate of autonomously-spreading successful franchise transplants from the North American continent (or more precisely, the so-called business format franchise),⁵ this case intrigued me because its central issues were whether asymmetry is a natural corollary of franchise contracts; and if so, what level of asymmetry should be tolerated by the law?⁶ The case was additionally interesting because it did not arise between a major U.S. franchisor and a mom-and-pop-type local franchisee, but was an indigenous Polish fledgling venture. As franchises were neither regulated by the Polish Civil Code, nor regulated by any law, the court was ex-

2. See Gillian K. Hadfield, *Problematic Relations: Franchising and the Law of Incomplete Contracts*, 42 STAN. L. REV. 927, 929, 938-39 (1990).

3. Decision of the Court of Appeal of Katowice, No. I ACa 636/98 (Mar. 4, 1998) (Pol).

4. Krzysytof Kaźmierczyk & Filip Kijowski, *Enforcement of Contracts in Poland*, in THE CASE LAW OF CENTRAL AND EASTERN EUROPE – ENFORCEMENT OF CONTRACTS 532-669 (Stefan Messman & Tibor Tajti eds., Eur. Univ. Press 2009). For the franchise case and commentary in English, see subsection 8.2.

5. See ANDREW KOSTECKA, *FRANCHISING IN THE ECONOMY*, 3 (U.S. Dept. of Commerce ed., 1985-1987). The discussion herein will be limited to what is known as “business format franchising,” defined by the US Department of Commerce as being “*characterized by an ongoing business relationship between franchisor and franchisee that includes not only the product, service, and trademark, but the entire business format itself – a marketing strategy and plan, operating manuals and standards, quality control, and continuing two-way communications.*”

6. The number of cases involving franchise-related disputes in Europe is small. No more than a handful cases focus on franchise-asymmetry, or touch upon that aspect of franchise. Still, the mentioned Polish one is hardly the only one. For example, the Finnish Supreme Court dealt with the enforceability of an arbitration clause in a franchise agreement in 1996. For a synopsis of the case, see Jouko Huhtala et al., *Validity of Arbitration Clauses*, INT’L LAW OFFICE (Mar. 11, 2004), <http://www.internationallawoffice.com/newsletters/detail.aspx?g=175c2dfb-61d2-48ae-a403-53e00908f4a2>. Examples can also be found outside Europe. See, e.g., the Canadian case *Ellis v. Subway Franchise Systems of Canada Ltd.*, 2000 CarswellOnt 1659 (Can. Ont. Sup. Ct. J.).

pected to grasp the essence of franchises from secondary sources of law. The franchisees (plaintiffs), among others, claimed that because of the asymmetry all risks shifted to them, their hands were tied and that there was no “equivalency of performance.”⁷ Reversing the first court’s decision, the appellate court, however, sided with the franchisors and proclaimed asymmetry to be a normal feature of franchise contracts, making it reconcilable with contractual freedom.⁸

Such hesitancy and indeterminacy in Europe should not be puzzling because franchises in many jurisdictions are still “new kid[s] on the block.”⁹ When the author in this paper was presenting on this particular topic, lawyers (typically from Continental legal systems) tended to be skeptical about the outcome of the Polish case as opposed to faculty from business schools – in particular experts of marketing. Put simply, while in the field of academia, franchises are still veiled with a degree of ignorance and misconceptions, in the world of businesses that is not necessarily so. For these reasons, during the ensuing years it became natural to the author of this paper to be more sensitive to the issue of contractual balance.

Notwithstanding the indeterminacy surrounding business format franchise especially in jurisdictions lacking franchise-specific laws, court and arbitral cases are bringing problems that have already been seen and decided upon in the U.S. Issues linked to asymmetry, are gradually appearing in Europe as well, such as the decision of the German Higher Regional Court of Thuringia.¹⁰ In that decision the Court denied the enforcement of an award rendered in the U.S. because of “gross disparity to the disadvantage of the franchisee” inherent to the arbitration clause imposed by the franchisor.¹¹

7. Franchise Agreement, FRANCHISING IN POLAND, <http://www.franchisinginpoland.com/franchise-law/franchise-agreement> (last visited Feb. 21, 2015); Decision of the Court of Appeal of Katowice, No. I ACa 636/98; Kaźmierczyk & Kijowski, *supra* note 4, at 654.

8. Decision of the Court of Appeal of Katowice, No. I ACa 636/98; *see* Kaźmierczyk & Kijowski, *supra* note 4, at 655.

9. Patrick Mayock, *Big Brands Playing the Growth Game in Europe*, HOTEL NEWS NOW (Dec. 4, 2012), <http://www.hotelnewsnow.com/article/14885/Big-Brands-playing%20the-growth-game-in-Europe>.

10. Ana Mercedes López Rodríguez, *Lex Mercatoria* (2002) (unpublished Ph.D. dissertation, Univ. of Aarhus), available at http://law.au.dk/fileadmin/site_files/filer_jura/dokumenter/forskning/rettid/artikler/20020046.pdf. [hereinafter *Lex Mercatoria*].

11. *Subsidiary Company of Franchiser v. Franchisee*, in 37 YEARBOOK OF COMMERCIAL ARBITRATION 2012, 220, 220 (Kluwer Law Int’l. 2012). As the holding of the decision stated “[e]nforcement of [the] ICDR [International Center for Dispute Resolution] an affiliate of the American Arbitration Association rendered in the United States was denied because the arbitra-

The other, ancillary is linked to the world of international commercial law and alternative dispute resolution; in particular, international commercial arbitration.¹² One may safely claim that asymmetry is not necessarily of relevance only in the context of business format franchise. Not necessarily on the front pages of contract or conflicts of law textbooks, yet parties from different jurisdictions wanting to choose a law sometimes would like to identify and choose a properly **balanced law**.¹³ Yet, despite the parties' intent and wishes, there is neither a test nor criteria to be used to determine whether the resulting contracts and laws used are balanced. In the lack of a generally applicable acid test, one is forced to rely on case-by-case improvisations in the quest for balance.

As no proper explanation or test has been developed, neither on franchise asymmetry, nor on what balanced laws (e.g., sales) mean, a closer exploration of the topic is more than justified. However, due to the current gap in scholarship, this article is inevitably seminal, and thus of an exploratory nature. As a consequence, not only do the contours of the central category of the ensuing elaboration remain fluid; but also, the concomitant practical and theoretical questions.

B. The Objective Agendas

Personal curiosities aside, contract asymmetry is far from being merely a fiction. In fact, contract asymmetry is a suitable subject for an inextricably complex theory. Contract asymmetry is a complex problem that creates a number of concrete tasks for legal scholars of both, practical and theoretical dimensions. Moreover, due to the global nature of the topic, it should be relevant to both sides of the Atlantic.

1. The Central Query: Franchise Asymmetry

A closer look at business format franchise reveals that asymmetry is a distinguishing characteristic of franchise contracts. Marketing experts more readily state that asymmetry is indeed a *sine qua non* of this particular contract. To the business world it is natural that the franchisor ought to have robust control rights, often amounting to the right to dic-

tion clause in the franchise contract, which provided mandatorily for a New York venue for the arbitration hearing, created a gross disparity to the disadvantage of the franchisee, a small German entrepreneur, and was therefore invalid under the Liechtenstein law, which applied to the arbitration agreement by an implied choice."

12. *Lex Mercatoria*, *supra* note 10.

13. PAUL FRIEDLAND & LOUKAS MISTELIS, 2010 INTERNATIONAL ARBITRATION SURVEY: CHOICES IN INTERNATIONAL ARBITRATION 14 (Sch. Int'l Arb., Queen Mary, Univ. of London ed., 2010).

tate virtually everything that is crucial to the franchisee. The business world would argue that the asymmetry is necessary for the proper protection of intellectual property rights and is also the key to the success of the entire system; even if the degree of asymmetry is far from being one and the same in the context of the prohibitive variety of franchises. Legal scholars – less in the U.S. and more in Europe – tend to be more hesitant to draw a conclusion on the meaning and relative weight of asymmetry. It might be legitimately speculated that this is to a great extent because of the continued rivalry of monist and pluralist contract theories. However, the existence and the important role asymmetry plays in the context of franchise should go uncontested.

Europe has undergone significant changes with regards to franchises, and is looking for the right franchise law formula for asymmetry for two very practical imminent reasons.¹⁴ On the one hand, due to the quintessential role civil codes (codification) play in the Continental systems, it is pivotal to consider whether to make a nominated contract out of franchise. If the answer is yes, what contours should be enshrined in the codes? On the other hand, in some jurisdictions the quest for the definition of franchise was prompted by regulatory reasons, namely the need to react to abuses. Unfortunately, the national systems' responses and the lack of guidance from Brussels amount to a cavalcade of restrictive and varied franchise laws. Such laws have additionally been crippled by the fact that the question whether mandatory rules-based regulation or rather the private law route should be elected has not been fixed yet. In some strong franchise jurisdictions only industry ethical standards (if any) govern. The common denominator of all the systems is that none of them has specifically identified asymmetry as a key corollary of franchise. In fact, one could not safely predict based on any of the laws what asymmetry is and what level of it should be tolerated.

The same could be concluded with respect to the recent code-like soft law instrument, the Draft Common Frame of Reference (DCFR).¹⁵ The DCFR came forward with presumably Europe's first complete set

14. Nick Pimlott & Martin Mendelsohn, *Reform of European Union Rules on Distribution*, FRANCHISING WORLD (Jan. 2010), <http://www.franchise.org/Franchise-Industry-News-Detail.aspx?id=49352>.

15. The text of DCFR can be downloaded from <http://ec.europa.eu/justice/policies/civil/docs/dcfr_outline_edition_en.pdf>. On the features, fate and a discussion on the DCFR franchise law, See Tibor Tajti, *Systemic and Topical Mapping of the Relationship of the DCFR and Arbitration* KAZIMIRO SIMONAVIČIAUS UNIV., VILNIUS, LITHUANIA, (2013). Note that the DCFR is nothing else but soft law, the idea that it could be transformed into Europe's first common civil code was dropped by the EU. See also Tibor Tajti, *The Unfathomable Nature and Future of the European Private Law Project*, 2 CHINA-EU L.J. 69-95 (2013).

of systematized rules on this contract.¹⁶ One could easily see that a franchisor-favoring asymmetry is recognized indirectly – adding up the meaningfully bigger number and more onerous obligations imposed on the franchisee – nowhere do the comments of the drafters (an elite pool of European Union private law scholars) note how meaningful a role asymmetry plays in the context of the new-comer franchise contract.

Because the business format franchise originated in the United States¹⁷, it is only natural to turn to the rich American history of this contract, including franchise regulation, the answers provided by courts adjudicating based on contract law, and eventually what contract theory says on the matter. Contrary to Europe, in the United States control is generally spoken of, one can identify a pro-industry (franchisor) and pro-franchisee scholarship¹⁸ together with a meaningful literature touching upon or departing from various concrete elements of asymmetry (even if named differently). Nevertheless, even American law seems to be devoid of proper answers to the issues faced by the Polish Appeal Court¹⁹: what is franchise asymmetry and what degree of it does the law tolerate? Thus, the issue of franchise and general contract asymmetry should be relevant to U.S. scholars too.

2. The Ancillary Query: Balanced Contracts

Going beyond the franchise context, there is a call to explore the possibility of applying the yet-to-be developed franchise asymmetry tests to other types of contracts. In other words, it could be validly sustained that the relevance of contract asymmetry is far from limited to the franchise relationship. No better illustration could be served than a brief look at the international scene, where the negotiating parties com-

16. Study Group on a European Civil Code & Research Group on EC Private Law (Acquis Group), *Principles, Definitions and Model Rules of European Private Law*, DRAFT COMMON FRAME OF REFERENCE, 4 (Outline ed., 2009).

17. ELIZABETH CRAWFORD SPENCER, *THE REGULATION OF FRANCHISING IN THE NEW GLOBAL ECONOMY I* (Oxford Univ. Press)

18. For an example of articles clearly reflecting the divide, see Paul Steinberg & Gerald Lescatre, *Beguiling Heresy: Regulating the Franchise Relationship*, 109 PENN ST. L. REV. 105, 113 (2004), where the authors identify David J. Kaufmann as a publisher that mainly represents the franchisors' positions after having become "politically astute" and "found[ing] the leading law firm in the country specializing in franchisor representation." *Id.* at 271. The title of the article by Peter C. Lagarias and Robert S. Boulter should speak for itself and for the position it takes: *The Modern Reality of the Controlling Franchisor: the Case for More, Not Less, Franchisee Protections*, 29 FRANCHISE L.J. 139 (2010). See also Robert W. Emerson & Uri Benoliel, *Can Franchisee Associations Serve as a Substitute for Franchisee Protection Laws?*, 118 PENN ST. L. REV. 99 (2013) (questioning the idea that independent franchise associations, which exist in Germany and UK, can efficiently prevent franchisor opportunism.).

19. Decision of the Court of Appeal of Katowice, No. I ACa 636/98.

ing from different jurisdictions try to agree on the application of a “balanced law.”²⁰ Although some major international contracts seem to have rested on a “balanced” or “non-asymmetric” law, one may wonder on the basis of what exact criteria (if any) the selection has been made, despite the lack of a commonly accepted test for “measuring” and “determining” asymmetry.

Invoking not just rich experiences with franchise law, but also the praise of the “American policy of inadequate bargaining power,” referred to by Lord Denning in the famous English case of *Lloyds Bank Ltd v. Bundy*,²¹ United States contract law scholars seem to be justifiably expected to react to the challenge and come forward with proper answers to the modest yet practical questions raised herein.

C. *The Hypotheses and the Roadmap to the Article*

This article rests on a number of hypotheses. First and foremost, asymmetry is a neglected yet quintessential feature of franchise as a *sui generis* type new-generation contract, the existence of which has been both presumed and targeted occasionally by regulation, notwithstanding its inherent vagueness. Secondly, asymmetry, as such, could be dissected. Based on the resulting cognitive achievements, a test of asymmetry could be formulated along with a suitable normative contract theory, more specifically, a pluralist and franchise-specific type.

In light of the above, this article will first try to circumscribe the notion of asymmetry and delimit it from the most important overlapping and neighboring categories of law. Thereafter, the second and “pragmatic” section will be aimed at illuminating more closely what real dilemmas surround contract asymmetry by taking business format franchise

20. See FRIEDLAND, *supra* note 13. The Queen Mary International Arbitration Study of 2010 found, for example, that when the bargaining power of the parties is equal (and none could impose home law and courts), “*Swiss law is the neutral law par excellence*,” even though only 37 percent of the interviewees were from Europe.; see Stefan Vogenauer, *Regulatory Competition through Choice of Contract Law and Choice of Forum in Europe: Theory and Evidence*, in REGULATORY COMPETITION IN CONTRACT LAW AND DISPUTE RESOLUTION 246 (Horst Eidenmüller ed., Oxford Univ. 2013) (citing The Oxford/Clifford Chance European Contract Law Survey (2005)).

21. See *Lloyds Bank Ltd. v. Bundy*, [1975] Q.B. 326, 333 (Eng.). Inadequate bargaining power would exist “*when the parties have not met on equal terms – when the one is so strong in bargaining power and the other so weak – that, as a matter of common fairness, it is not right that the strong should be allowed to push the weak to the wall.*” *Id.* at 336-37. “However, the case was about a personal guarantee of father to support his son’s company and Lord Denning’s view was eventually rejected because “*the lengths to which American courts have gone in implementing this policy would hardly be acceptable in England without express legislative authority.*” See EDWIN PEEL, TREITEL ON THE LAW OF CONTRACT § 10-049, at 408 (Sweet & Maxwell, 13th ed. 2011).

contracts as benchmarks. This article will review the evolution of franchise law in the United States and the franchise law of Europe, which obviously lags behind. It will be shown that the dilemmas surrounding control and contract asymmetry have always been presumed and reacted upon; the latter being characteristic primarily of the United States and much less so of Europe. The *third*, and “theoretical” section, will briefly summarize what contract theories have achieved so far. The conclusions rest on the hypothesis that exploring contract theory could ease the tension stemming from the indeterminacy of asymmetry, be it for the sake of increased predictability, economic efficiency, protection of the weaker party or simply to help regulators and lawmakers. With these presumptions in mind, this article ultimately concludes that deconstruction of asymmetry, and on basis of that, forging of a proper normative contract theory is not just desirable but possible as well.

II. ASYMMETRY DEFINED

A. *Delimiting the Scope of Inquiry: Franchise Asymmetry as Benchmark*

Notwithstanding the relative importance of global contract theories, nothing prevents concurrent support for a franchise-specific pluralist normative contract theory on asymmetry – the primary focus of this article. In lieu of searching for a global contract theory, for one applicable to all contract types, the focus is narrowed down to franchise contracts. The exploration of the possible application of findings to other types of contracts, whether for closer clarification of what balanced contracts are or for any other reasons, awaits other scholars. Put simply, a paradigm business franchise contract is the benchmark.

Therefore, the primary point of departure for the purposes of this article is that a franchise contract is characterized by a meaningful, gross-inequality of the parties, clearly tilting the balance to the benefit of franchisors. This tilt in favor of the franchisor is also normally reflected in the provisions of the underlying contract, which then qualify as asymmetric contracts. The franchisor’s right to encroach and establish additional outlets in the neighborhood or in the close vicinity of the franchisee might be a suitable example that is normally explicitly provided for. This means that we will try to take a look at franchise asymmetry primarily from the perspectives of drafters of franchise contracts, as well as franchise law regulators. Considering encroachment as a suitable example, the issue of whether the franchisor’s right to encroach is a tolerable form of asymmetry, or whether laws should either exclude it or limit it, becomes apparent.

It is fair to say that literature has so far focused on understanding and explaining the nature of franchise. This literature has included discussions pointing to information and strategic asymmetry.²² Presently, most franchise laws tackle only the former through mandatory or quasi-mandatory disclosure.²³ Based on the still modest but growing number of publications approaching franchise from a comparative perspective and the topics they typically focus upon, it may be concluded that a relatively wide consensus has been reached only with respect to the first type of asymmetry.²⁴ This protection is inherently limited given that it “is aimed primarily at preventing abuses or surprises in the contractual formation stage, rather than in the [later] termination stage.”²⁵ Strategic asymmetry – which some scholars attribute to the relational nature of franchise²⁶ – unquestionably plays a key role in the life of franchise. Yet, one could hardly speak of a consensus among scholars. Much of what follows will result from the effect that strategic asymmetry has on franchise.²⁷

B. The Fluid Pool of Overlapping and Competing Designations

Contract asymmetry is a fluid concept. It has often been discussed without having been firmly defined.²⁸ An exacerbating factor is that the term itself has been subsumed under some other similarly amorphous terms. One of them is the category of “neutral law;” a reference to such

22. Rosa Lapiedra, et al., *Managing asymmetry in Franchise Contracts: Transparency as the Overriding Rule*, 1488, Management Decision. Vol. 50, Iss. 8 (2012).

23. Reference is made to industrial self-regulations, which provide for disclosure, yet – because of the very nature of these sources of law – their enforcement is left to the industries themselves. This is far from the mandatory rules of regulations normally passed by legislation.

24. See Lapiedra *supra* note 22; See e.g. Spencer *supra* note 17.

25. Pannal Alan Sanders, “At Will” *Franchise Terminations and the Abuse of Rights Doctrine*, 42 LA. L. REV. 209, 215 (1981). Although Sander’s claim was made in 1981, it remains valid today.

26. See, in particular, Gillian K. Hadfield, *Problematic Relations: Franchising and the Law of Incomplete Contracts*, 42 Stan. L. Rev. 927 (April 1990), at 991 concluding that franchise contracts are ‘highly incomplete,’ especially because the parties cannot “specify how the parties are to exercise [the franchisor’s powers].” Such incomplete contracts are therefore incapable of controlling franchisor opportunism that mainly stems from its superior strategic position.

27. See PAUL CRAIG & GRÁINNE DE BÚRCA, *EU LAW: TEXT, CASES AND MATERIALS* 934-36 (Oxford Univ. Press 1997).

28. *Id.* at 934 (Oxford Univ. Press 1997). Illustrative in that respect is the venerable textbook on EU Law by Craig and Búrca when dealing with the relationship of franchise and competition law obiter admits that “[i]t is of the essence of franchise that the franchisor will require the franchisee to comply with certain standards and methods of sale for the product in question” and “[i]t is also central to the franchising system that the franchisor be enabled to impose terms which serve to protect the intellectual-property rights which have been assigned to the franchisee.”

a system of norms which have achieved some equilibrium.²⁹ On an abstract level, obviously the products of neutral laws are balanced, in comparison to asymmetric contracts. The problem, already hinted at, is that theories on neutral law remain abstract, rest on indeterminate criteria, and are hardly panacea to the franchise query.

Some authors have spoken of franchises as **one-sided contracts**, characterized by the “gross inequality in bargaining power which usually exists between the franchisee and the more powerful franchisor” which is “the primary source of abuse”³⁰ Yet, if we stick with Bebchuk and Posner’s definition, defining one-sided contracts as “contracts containing terms that impose a greater expected cost on one side than benefit on the other,”³¹ one could see that one-sided and asymmetric contracts could be taken as full equivalents only if subscribing to the view of law and economics that everything could eventually be expressed in terms of a cost-benefit analysis. Such a proposition requires the use of mathematical formulas: a dead-end. Referring back to our Polish case, such math-based cost analysis hardly could be expected from judges charged with the task of determining what asymmetry is concretely, and to what degree it should be tolerated.³² This paper proposes a simpler, math-free test, which simply tries to answer the question: Is contracting for the franchisor’s right to encroach as an asymmetric power belonging only to one party to the contract tolerable?

Factors that further contribute to blurring the picture are that courts combating asymmetry took opposing views: some saw asymmetric contracts as nothing else but a type of adhesion contracts, while others viewed franchise as contracts made by merchants standing on equal footing, and thus intervention for the protection of the weaker party is not justified.³³ Contrary to earlier scholarship, today the prevailing opinion is that the picture is much more nuanced and that franchise dilem-

29. FRIEDLAND, *supra* note 13 (finding that when the bargaining power of the parties is equal and none could impose home law and courts); “*Swiss law is the neutral law par excellence*,” even though only 37 per cent of the interviewees were from Europe; See Vogenauer, *supra* note 20, at 251.

30. Sanders, *supra* note 25, at 212-13.

31. Lucian A. Bebchuk & Richard A. Posner, *One-Sided Contracts in Competitive Consumer Markets*, 104 MICH. L. REV. 827, 827 (2006).

32. Kaźmierczyk & Kijowski, *supra* note 4.

33. See, e.g., *Texaco, Inc. v. A.A. Gold*, 357 N.Y.S.2d 951 (1974). In the case, the contract gave the right to the franchisor to evict the franchisee on 10 days notice. The court – referring to the 19th century case *Printing & Numerical Registering Co. v. Simpson*, 19 Law Rep. 462, 465 (1875) (held that “*men of full age and competent understanding shall have the utmost liberty of contracting*”). For critique of the decision, see Steinberg & Lescatre, *supra* note 18.

mas cannot be resolved by resorting to rules on adhesion contracts.³⁴ For one thing, the category of adhesion contracts is broader than and qualitatively different from the category of asymmetric contracts.³⁵ Further, it is a fact that an additional layer of protective tools has developed since the 1970s to specifically protect franchisees, which can be indirectly taken as evidence that the rules on adhesion contracts were clearly insufficient.³⁶ It is commonly recognized that “contract law has [failed] to forge adequate tools for coping with contracts of adhesion.”³⁷ It may be speculated that this is partly attributable to non-differentiation of various one-sided contracts – including the asymmetric ones. Namely, the rules on adhesion contracts were also coined based on conventional, one-shot type contracts (the so-called “discrete transactions”),³⁸ whereas franchise belongs to the category of long-term relational contracts.

The category of **exploitative contracts** may as well come into picture at this junction. Aside from the obvious linkage of the two, one cannot but conclude that distinct problems are corollary to them. If exploitation “demarcates the line between legitimate and objectionable forms of advantage taking in contract bargaining encounters,”³⁹ exploitative contracts, therefore, are those that transgress a thin line – in our case, the tolerable level of asymmetry. The issue is how to determine a tolerable level of asymmetry, considering the lack of a test for asymmetry. Furthermore, not all asymmetric contracts are inherently exploitative. In other words, it may be argued that the tolerable level of asymmetry – if a test, which this article is looking for, is formulated – may be also the litmus test for determining the threshold that divides exploitative asymmetric contracts from their innocent brethren.

Put simply, it is one of the contentions of this article that a distinct

34. Bebchuk, *supra* note 31, at 828. As Bebchuk and Posner put it, though speaking of standard form consumer contracts filled with boilerplates: “An older, and pretty well discredited, scholarly literature thought the absence of bargaining showed that the seller must have monopoly power, enabling him to foist on consumers whatever terms he liked.”

35. BLACK’S LAW DICTIONARY 318-19 (7th ed. 1999). For example, Black’s Law Dictionary points to consumers as typical “weaker parties” when defining adhesion contracts as “standard form contract[s] prepared by one party, to be signed by the party in a weaker position, usually a consumer, who has little choice about the terms.”

36. See, e.g., E. ALLAN FARNSWORTH, CONTRACTS §1.7 at 20-21 (4th ed. 2004). Compared to banking, insurance, transportation or communications, regulation of the franchise industry is less intensive even in the most activist regulatory jurisdictions; still the trend seems to be similar even if slower and less intense.

37. See JOHN D. CALAMARI AND JOSEPH M. PERILLO, THE LAW OF CONTRACTS §1.5, at 15 (4th ed. 1998).

38. *Id.*

39. See RICK BIGWOOD, *Exploitative Contracts* 130 (2003).

category of asymmetric contracts should be recognized by theory. More precisely, the pair of asymmetric versus balanced contracts deserves a place in contract law. Asymmetric contracts differ from the competing categories of adhesion, exploitative, and other contract categories. The main justification for arguing that a distinct place in contract law should exist is the fact that forcing them under the same roof would not bring fruit to the very problems inherent to paradigm asymmetric contracts of the franchise sort. For example, both the conclusion of a contract by purchasing a ticket to make use of the service of the Tube in London and a fast food franchise contract may qualify as an adhesion contract, but they radically differ on a number of distinguishing criteria and linked policy issues.

III. THE PRAGMATIC AGENDA: THE FRANCHISE SAGA

A. *Franchise in the United States*

1. A Brief Account of the History of Franchise in the United States

The United States is not only universally cited as the cradle of business format franchising; it also continues to host one of world's largest franchise industry.⁴⁰ This includes an unprecedentedly powerful and internationally active group of franchisors commonly looked upon as benchmarks for what this business model is supposed to resemble all over the world, albeit the earliest cited franchisor-abuse case stems from the heydays of American automobile industry.⁴¹ Only traditional contract doctrines, then existing tort law and other classical branches of law – as supplemented by equity – could have been employed to protect (if at all) the vulnerable franchisees until the early 1970s denoting the arrival of the still ongoing regulatory era. As opposed to the pre-1970 classical era, characterized by remedies predominantly having ex post effects, regulations are featured primarily by legal paraphernalia of ex ante nature⁴² This distinction is of crucial importance because the franchisee, who is about to invest all his life savings or has already lost all

40. See IHS GLOBAL INSIGHT, FRANCHISE BUSINESS ECONOMIC OUTLOOK: MAY 2012 1 (2012), available at <http://emarket.franchise.org/BusinessOutlookReport2012.pdf>; see also SPENCER, *supra* note 17, at 1. According to a recent study, 748,680 franchise establishments, 8,106 million jobs, provision of goods and services worth \$781 billion and contribution to GDP worth \$461 billion could be linked to business format franchise.

41. See *Ellis v. Dodge Bros.*, 246 F. 764 (5th Cir. 1917) (where the fate of a precarious investment of an Atlanta franchisee was decided upon regarding unfair termination expressly permitted by the underlying agreement).

42. See Roy Kreitner, *The Future of Contract Theory: On the New Pluralism in Contract Theory*, 45 SUFFOLK U. L. REV. 915, 929 (2012).

his franchise-investments due to the abuses or opportunistic behavior of the franchisor, is hardly in the position, financially and strategically, to launch a time-consuming expensive litigation; especially given the vague exceptionally applicable contract law principles. The resistance of the franchise industry against regulations is perhaps the best indirect proof of the regulations having “sharper teeth.” Thus, the essence of the regulations is mandatory rules coupled with enforcement (primarily) by dedicated governmental agencies.

For our purposes, it suffices to assume that two main franchise-regulatory models have been designed in the U.S.: the weaker disclosure laws and their stronger kin, the ‘franchise relationship’ laws⁴³ Both aim to counterbalance the franchisor-benefitting asymmetry inherent to franchising. They differ on two main points. *First*, while the disclosure variants cover only the phase preceding the conclusion of the franchise contract, the latter extend also to the post-sale relationship. *Second*, notwithstanding the state-level variations, all disclosure systems merely ensure that the prospective franchisee is informed of a select number of key issues in the franchisor’s offer. Franchise relationship laws, on the other hand, are much more “paternalistic,” resulting in the aggregate effect of much more protection to the franchisee. However, relationship laws exist only in a handful of the states – led by California, Maryland and Iowa, which are deemed to be the most protective systems – and these laws are not setting a trend in other jurisdictions in the United States or abroad.⁴⁴

These facts are, however, of key importance not just for the US. First and foremost, American franchisors are responsible for the spreading and transplantation of highly standardized franchise terms and conditions. Consequently, approaches similar to the American franchising practices have manifested all over the world, ensuring that worldwide franchise law rests on similar (if not identical) foundations. It is hardly an exaggeration to claim that franchising has become a *sui generis* form of true *lex mercatoria* (or a-national law).⁴⁵ The natural repercussion of this is that foreign lawmakers and arbitrators – and perhaps to a lesser extent also foreign courts – may look to U.S. law as a source of inspirations.⁴⁶ Another, rarely discussed consequence of American dominance in the realms of franchise, is the transposition of American domestic

43. Larry A. DiMatteo, *Strategic Contracting: Contract Law as a Source of Competitive Advantage*, 47 Am. Bus. L.J. 727, 749 (2010),

44. Franchise Agreement, *supra* note 7.

45. *Lex Mercatoria*, *supra* note 10, at 47.

46. Steinberg & Lescatre, *supra* note 18, at 273.

theories on the international scene.⁴⁷ In other words, franchise trends in the United States are relevant to the global community.

2. The Regulatory versus the Contract Law Agenda

Based on the above, one could conclude that the law on franchise is in turmoil in the United States. Misleadingly, one may get the impression that the central issue has been narrowed down to how much regulation is needed. Consequently, the role of contract law has been reduced to the level of supplementary legal aids that could remedy only the exceptional cases that reach courts. Alternatively, as the proponents of regulation of the most far reaching relationship law-type state, “reliance on judicial or arbitral application of equitable principles is insufficient, and statutory mandates are required to make franchisors responsible for the consequences of opportunistic behavior.”⁴⁸ The full picture is, however, that three layers of franchise laws could be differentiated in the United States: the most important being regulations passed on the federal and state levels (*the first layer*), as supplemented by industrial self-regulation (*second layer*), and classical branches of law (*third layer*).

What is puzzling is the fluid nature of franchise asymmetry, a common ground for both the regulatory and the classical contract layers. Additionally, none of the franchise laws deny the legitimacy of franchise asymmetry. This includes even the farthest reaching relationship laws, which aim only to counter and prevent the potential abuses by franchisors rather than swinging back the balance-pendulum. Specific limitations – like California limiting resort to arbitration – are the exception rather than the rule.⁴⁹ Remarkably, the system survives and grows notwithstanding its obscure complexities, including our central question of what level of asymmetry should be tolerated.

When, for example, Steinberg and Lescatre forcefully vouch for more regulation (“statutory mandates”), they categorically request also taking into account, among others, “the nature of franchise contracts,”⁵⁰

47. See Steinberg & Lescatre, *supra* note 18, at 273. Steinberg and Lescatre mentioned the example of International Franchise Association’s (IFA) role played on the international scene, which was aimed at “ensur[ing] that overseas legislation, if any, covers only the brief period prior to the signing of the franchise agreement and not the franchise relationship itself, which can last for a period of 20 years or more.” This included also its impact on the final output of UNIDROIT – the Guide to International master Franchise Arrangements (now existing in its 2nd version from 2007). According to these experts, albeit IFA proclaims to equally represent both franchisors and franchisees, that is nothing more than “self-proclaimed neutrality.”

48. *Id.* at 113.

49. *Id.* at 251.

50. *Id.* at 114.

yet without clarifying what that concretely entails. They do list the relational nature,⁵¹ the often-present concerns of vulnerability known to consumer protection laws,⁵² the legitimacy of franchisor discretion⁵³ and the “element of uncertainty” inherent to the introduction of such abstract principles as “good faith and fair dealing.”⁵⁴ Despite acknowledgement of all these issues, the question of the tolerable level of asymmetry has not addressed. Moreover, they admit that a living pattern of “balanced contracts” is already in place in America: the one applicable to the auto and petroleum industries “provid[ing] all parties with a profitable relationship.”⁵⁵ True, IFA denies and objects to the idea of transposition of the same pattern to other types of franchises.⁵⁶ These corroborate the conclusion that balanced franchise legislation does occur in the United States.

B. Franchise in Europe

1. A Brief Account of the History of Franchise in Europe

Few would contest that in Europe business format franchise is a business contract imported from the U.S., the first pioneering variants of which first appeared in the UK in the 1950’s and from the 1960’s on in other Western European countries.⁵⁷ By the 1990s, Central and Eastern Europe (CEE) had also joined the club and the spreading of franchise continues virtually throughout Europe even today.⁵⁸

The quantitative data for any of the last few years, however, proves that Europe is far from meaningfully exploiting the economic potential hidden in franchises. In 2010, for example, the estimated turnover of franchised businesses was \$863,300 billion in the U.S., while the same figure in the EU amounted only to \$300 billion.⁵⁹ This is clearly unsatisfactory bearing in mind that the population of the U.S. is

51. *Id.* (presuming under relational contracts “contracts between parties anticipating continuation of a relationship following signing of the contract”).

52. *Id.* at 107.

53. *Id.* at 315.

54. *Id.*

55. *Id.* at 315.

56. *Id.* at 315.

57. See Philip Mark Abell, *The Regulation of Franchising in the European Union* 59 (published thesis, Queen Mary, Univ. of London) (2011) at 12. Abell listed the following brands: Wimpy (UK, 1955), Service Master (UK, 1958), Golden Egg Restaurants (UK, 1965), Dyno Rod (UK, 1966), Ihr Platz (Germany, drugstore), Nordsee (Germany, fish restaurant). In Germany, the process intensified after reunification in 1991. [hereinafter Abell Thesis]

58. *Id.* at 37.

59. MARK ABELL, *THE LAW AND REGULATION OF FRANCHISING IN THE EU* 26 (Elgar, 2013).

roughly 60% of the population of EU and that the GDP of the U.S. is also lower.⁶⁰ Moreover, franchising is unevenly present throughout parts of the EU.⁶¹ Special governmental programs aimed at boosting franchises are the exception, rather than the rule.⁶² Even though this unfulfilled agenda is increasingly noted, Brussels has not taken any concrete steps.⁶³ Surprisingly, this lag might turn out to be the key reason for making franchising a priority agenda item.

2. The Distinguishing Features of European Franchise Laws

Canvassing the broader picture is pivotal before jumping to the issue of asymmetry. Because franchise as a business model is in the process of development, much less scholarly or industrial publications are available in Europe compared to the U.S. This applies especially to the level of the EU because – with the exception of the Draft Common Frame Deference (“DCFR”), which contains quite a promising franchise law model – franchise law remains in the bailiwick of national legislations, leading to substantial differences.⁶⁴ In contrast, American pro-franchisor versus the pro-franchisee scholarship is already openly debated.⁶⁵ This is not necessarily the case in Europe, where basic policy issues remain unanswered. Regulatory capture is hardly spoken of though the regulation of franchise became part of political games – Abell speaks of “*political cynicism*”⁶⁶ and populism⁶⁷ – in some coun-

60. *Id.* at 49.

61. *Id.* at 20-26.

62. *See id.* at 16. Abell mentioned Italy which has made €350 million available to support franchisees with investment grants and soft loans. *Id.* at 286. Abell, who concludes his book with a claim that “[f]ranchising has failed to fulfil its potential in the EU [what is] in part due to the regulatory environment.”

64. *See* STUDY GROUP ON A EUROPEAN CIVIL CODE & THE RESEARCH GROUP ON EXISTING EC PRIVATE LAW, PRINCIPLES, DEFINITIONS AND MODEL RULES OF EUROPEAN PRIVATE LAW 2395 (Christian von Bar & Eric Clive eds., 2010). Franchise is located in DCFR Book IV on Specific Contracts under the same roof with commercial agency and distributorship (Part E) in the separate chapter 4. Altogether 14 sections are devoted specifically to franchise though quite a number of rules apply equally to agency and distributorship. Albeit the comments note that “*franchise networks are characterized by a much stronger uniformity than ordinary distribution contracts*” control and asymmetry is neither specifically noted nor targeted. However, based on the content of most of the provisions it cannot escape attention that the rules attempt to find the right balance, however, by recognizing the importance of franchisor control through heavily asymmetric set of rights of franchisor and obligations imposed on the franchisee.

65. *See* Steinberg & Lescatre *supra* note 18, at 271. Steinberg and Lescatre mentioned the case of David J. Kaufmann, who while in the shoes of the Deputy Attorney General drafted the New York Franchise Act, “*a tough disclosure law that remains one of the most comprehensive in the U.S.*” Later he founded “*the leading law firm in the [US] specializing in franchisor representation,*” and has published on franchise yet speaking from a different position.

66. ABELL, *supra* note 59, at 59.

tries.

Another side of the coin is that incomprehension of the nature and role of franchise makes lawmakers hesitant to recognize it as a distinct nominated contract. This applies especially to the economic engine of Europe: Germany, the laws of which otherwise serve as a model for quite a number of jurisdictions in Europe.⁶⁸ The regulatory landscape is roughly the same in the UK, another major economy and legal system of Europe, with the systemic distinction that codification plays a much less important (if any) role in common laws.⁶⁹ Hence, the issue whether to nominate franchise or not is of little (if any) relevance for English (as opposed to Scotland with its mixed legal system) lawyers. Needless to say, these are directly linked to the following distinguishing features of European franchise laws.

First, the variety of approaches to franchise in Europe is significantly bigger than on the other side of the Atlantic. Moreover, it is meaningful that in a number of jurisdictions franchise has not been fully understood yet. It should not come as a surprise that quite a number of them have no franchise-specific law,⁷⁰ in others they could speak only of first generation, not necessarily mature regulations. Second, as the countries in which the overwhelming part of European franchise is concentrated (in particular Germany and the UK) rely on self-regulation (codes of ethics), this could comfortably be taken as the ‘European franchise regulatory model.’⁷¹ In these systems, in other words, only the

67. *Id.* at 60. This was the case in Belgium in which passage of the first franchise statute took 24 years and five bills. For example, according to Abell the 2001 bill was brought before the parliament as a populist move because the overwhelming part of the franchisors was made of foreigners.

68. *Id.* at 40-43, 105. German scholars seem to be lagging behind developments in the economy because, according to the prevailing view, franchise is not a self-standing ‘nominated’ contract with its own idiosyncratic features. Thus, the discourse is about whether the rules on licensing of IP, service, shareholders’, business management, lease or distribution (agency) could be applied by analogy to franchise. See Zsófia Oláh & Csongor István Nagy, *Enforcement of Contracts in Hungary*, in THE CASE LAW OF CENTRAL AND EASTERN EUROPE - ENFORCEMENT OF CONTRACTS 288-89 (Stefan Messmann & Tibor Tajti eds., 2009). One may legitimately wonder how predictable such “franchise law” and how just such a solution is (given that in commercial law predictability is what generates justice). Albeit, the new Hungarian Civil Code of 2013 (stepping into force on the 15 March 2014) has introduced franchise as a new nominated contract; this was not the case earlier. Or, in other words, the law suffered from the same malady as present time German law. From the few publicized Hungarian high courts cases, one properly illustrate that this level of indeterminacy may be detrimental: in the case the outcome of the case was different depending on whether the rules on commission (due diligence sufficient) rather than undertaking (achieving a particular result is required) contracts are applied.

69. See ABELL, *supra* note 59, at 217-18.

70. See *id.* at 20.

71. See generally *id.* at 117, 119, 201.

vague codes of ethics and general laws (in particular contract and tort law) protect (if at all) franchisees.⁷² It should not come as a surprise then, the third distinguishing feature is that in Europe – at least as Abell proclaims⁷³ – the prevailing opinion is that the European regulation should not be devoted only to protection of franchisees;⁷⁴ contrary to the opinion in the US.⁷⁵ Fourth, there is no sharp differentiation among the three layers of law on franchise in Europe. It is often thought that it does not matter whether regulations in a narrower sense (characterized by mandatory norms and ex ante protections), mere civil code provisions with ex post effects⁷⁶ or self-regulatory law, apply to franchise.⁷⁷ A look

72. See *id.* at 221.

73. See Abell Thesis, *supra* note 57, at 8. As he put it: “*The desirability of protecting the rights of franchisees is not disputed within the thesis. However, . . . this should not be the only purpose of regulation and that a balance must be struck between the protection of the rights of franchisees and the need to re-enforce the economic drivers that encourage both franchisors and franchisees to become involved in franchising in the first place. It is suggested that excessive protection of franchisees can have detrimental effects on both franchising and on the Single Market.*”

74. See ABELL, *supra* note 59, at 61-62. This general claim of Abell is hardly substantiated and it is not clear on what he has based it. Let us briefly list only the main counter-arguments. *First*, most of the European systems having franchise-specific law have passed those laws, indeed, (primarily) to protect the franchisees. This was the case in France, Spain and Sweden having faced at least one (if not a series) of abuses. In addition he admits that in France, “Law No. 89-1008 of 31 December 1989 was adopted due to the proliferation of abuse, sharp practice and commercial failure in franchising.” Similar franchisor abuses became major themes of the media in Germany (the case of Foto Quelle, Kindervilla – children’s nurseries) and the UK (Self Video 24). *Id.* Secondly, the parliamentary debates on the Belgian franchise bills were clearly centered around the realization that “franchisors usually offer franchises on a ‘take it or leave it’ basis and that there is a clear imbalance between the rights and obligations. . . .” ABELL, *supra* note 59, at 59. *Id.* at 289. Thirdly, Abell’s some other major conclusions contradict his own position. In the conclusions, for example, he claims, “[while the existent] contractual environment in the EU supports the economic drivers that encourage franchisors to become involved in franchising. It does not adequately support all of the economic drivers that encourage franchisees to become involved in franchising.”

75. See, e.g., California Franchise Investment Law Preamble (CAL. CORP. CODE § 31001 (1970)), which reads: “*It is the intent of this law to provide each prospective franchisee with the information necessary to make an intelligent decision regarding franchises being offered.*”

76. See, e.g., ABELL, *supra* note 59, at 292 vouching for EU-wide harmonization either via directives or a common European civil code. Mistaking regulations in a narrower sense (i.e., mandatory norms enforceable by dedicated agencies ex ante and primarily by regulatory tools) with mandatory norms in civil codes (i.e., mandatory norms but enforceable by the private parties ex post and offering only injunctions and damages as remedies) is also known. See, e.g., *Id.* at 68. This is a major problem because the chances of litigation and winning of a case by the normally mom-and-pop type franchisees are minimal. In other words, unless regulations enforced by dedicated agencies are in place, essentially nothing protects such franchisees from opportunistic behavior of franchisors.

77. ABELL, *supra* note 59, at 288. The clear proof that self-regulatory regimes do not work is that the BFA has expelled fewer than 5 members in the period of 1997 – 2007. As Abell concluded, and the author of this paper agrees: “[t]he inevitable conclusion . . . is that franchising needs to be legally regulated in the EU and that self-regulation lacking transparency, consisten-

at U.S. experiences clearly shows the detrimental effects this shortsightedness may have.

There are a number of points, however, on which European and U.S. franchise laws resemble each other, sometimes unusually closely. *First* of all, as a U.S. import, franchise contracts are modeled on contracts used in the U.S. and are thus filled with elements and features known on the other side of the Atlantic.⁷⁸ Such “*uniform architecture*”⁷⁹ means, for example, that a clause allowing for franchisor encroachment is a regular corollary of contracts no matter whether the franchisees are from Europe or the U.S.⁸⁰ This is one of the key reasons why one may safely presume that franchise contracts are equally asymmetric on both sides of the Atlantic, and are thus only minutely affected by the different means by which labor and agency law may interfere.

As Europe builds a form of social-market economy⁸¹ and, therefore, tends to be more paternalistic, it is fair to claim that the chances of such interferences, theoretically, are more realistic in Europe. A similar vagueness applies to the way in which the characteristically European principles of contract and private law apply to franchise law.⁸² As these function similarly to equitable principles in common laws, it is more realistic to conclude that there is meaningful similarity on this front as well. Thus, conclusions related to U.S. law according to which “[r]eliance on judicial or arbitral application of equitable principles is insufficient, and statutory mandates are required to make franchisors responsible for the consequences of opportunistic behavior”⁸³ applies *mutatis mutandis* to the general principles of civil laws. *Finally*, franchise has been on some points linked to investments and, thus, to capital markets, though in Europe to a lesser extent than in the U.S.⁸⁴ As a result,

cy, accountability and proportionality will never be able to provide franchisees, potential franchisees or indeed franchisors with the level of protection that they require.”

78. See ABELL, *supra* note 59, § 3.5. As per the samples used by Abell allegedly civil law franchise contracts were normally shorter because the parties relied on the code or statutory provisions (where available). However, many civil codes contain no franchise-specific provisions and it is doubtful that the large US franchisors appearing on European markets are willing to depart from the well-tested patterns applied overseas. Offering such general principles as the German general duty of good faith (art. 242 of the German Civil Code as the full-proof supplement of detailed contract language, however, is highly dubious).

79. *Id.* at 63, 289.

80. ABELL, *supra* note 59, at 63 and 289.

81. *Id.* at § 3.1.

82. Interestingly, while some US authors tend to attribute way too much to these cog-wheels of civilian systems, the truth is that only scholars, rather than strings of court or arbitral cases, could corroborate such contentions.

83. Steinberg & Lescatre, *supra* note 18, at 113.

84. See ABELL, *supra* note 59 at 15. The expansion of franchise was slowed down in the UK

protection of franchisees through securities regulation is foreign to Europe.⁸⁵

As far as control and asymmetry in general are concerned, the European approach is similar to that in the US: they are discussed (rarely, if at all)⁸⁶ as a natural *sine qua non* of franchise,⁸⁷ but without even trying to clarify what that means and what the tolerable levels are.⁸⁸ This vagueness is exacerbated by the general immaturity of franchise laws (if any), and further exacerbated by unclear policy positions.⁸⁹ However, if one takes the DCFR as representing what the majority of European private law experts recommend for Europe (*de lege ferenda*) – including the first more or less full-scale set of systematized provisions on franchise⁹⁰ – then one could validly claim that the time is ripe for making firm policy positions including the fundamental concepts of control and asymmetry.

IV. THE THEORETICAL AGENDA: WHAT CONTRACT THEORY COULD OFFER

Admittedly, a book could be written on what theory could offer to franchise and general contract asymmetry. This article illuminates more closely what asymmetry means by deconstructing it. First, one such seminal model is offered by this article in the next sub-section. Secondly, theory could promote, if not a decisive test, then closer guidelines based on the outer limits of franchise asymmetry. Third, asymmetry

in the 1960s, indeed, because franchising was liked to pyramid selling (i.e., pyramid and Ponzi schemes). To wit, purchasers of franchises (investors) are incentivized to further sell subdivisions of the franchise until newcomer investors could be found. Abell was also referring to Adams and Pritchard Jones, *Franchising: Practice and Precedents – Business Format Franchising*, 1997) *Id.* at 216. The exclusion of sophisticated franchisees, similarly to FTC Rule's threshold of US\$1 million, resembles the contemporary discussion on the reform of securities disclosure systems as well; subscribed to also by Abell.

85. ABELL, *supra* note 59, § 3.5

86. *See id.* at 244. Abell is right when pointing to the deficiencies of the DCFR, including the failure to deal with “*the brand, the franchisor’s control of the franchise or the support provided to the franchisees. . .*” (emphasis added).

87. *See id.* at 65. As Abell put it “*Control by the franchisor is a key element in the relationship.*”

88. *See id.* at 337. Abell lists control as one of the six basic features of franchise (i.e., independence of the parties involved, economic interest, a business format, control of the franchisee by the franchisor and the provision of assistance to the franchisee) and then obiter makes a claim that franchise is characterized by “*contractual asymmetry due to the multi-lateral nature of the franchise relationship (each franchisor having several/many franchisees) and the long term, dynamic and changing nature of the franchisor/franchisee relationship.*”; *Id.* at 55. Then, questionably, he sees information asymmetry to be a substantial the risk of the franchisor.

89. ABELL, *supra* note 59, § 3.5

90. *Id.*

could legitimize the test based on known normative theories. Given that the ultimate task is to find the proper balance, even if asymmetric and ensuring franchisor control, pluralist rather than monist theories should be employed. The balance is found by relying on efficiency – to support the asymmetry benefitting the franchisor – and on the need of the protection of the weaker party, the franchisee. Finally, on the basis of that, theory could explore whether the test of asymmetry could be applied also for other types of contracts or rather it should be uniquely limited only to franchise contracts.

A. Asymmetry Deconstructed

Franchise contracts may serve to dissect asymmetry into its constitutive elements. It is presumed that asymmetry, as an abstract notion, is made of concrete, specific, and overlapping elements of varying levels of abstraction.⁹¹ Various sources emphasize different features and facets of the phenomenon, which somewhat blur the picture.⁹² The presumption – deduced from the aggregate of US franchise law (i.e., all layers of law governing franchises) – is that the law recognizes the franchisor's right to control the franchise system up to a relatively high degree.⁹³ Control, on one hand, rests on asymmetries that are tolerated by the system.⁹⁴ In other words, the level of franchisor's control recognized by a given system is directly commensurate to the number, types, and intensity of asymmetries normally expressed in explicit contractual clauses, but not all strategic advantages could be directly linked to concrete contractual provisions.⁹⁵

Three main types of asymmetries could be differentiated: those resting (primarily) on specific legal tools (law-based asymmetries), information (informational asymmetry), and asymmetry derived from the superior financial or strategic positions of franchisors (information versus superior strategic position-based asymmetries).⁹⁶ Here, admittedly, some strategic advantages are inherent in the rights and powers provided by the franchise contract.⁹⁷ When a major franchisor negotiates, for instance, the franchisor's superior bargaining position is not exclusively

91. See generally Rosa Lapiedra, Felipe Palau, & Isabel Reig, *Managing asymmetry in franchise contracts: transparency as the overriding rule*, 50(8) EMERALD INSIGHT, 1488-99(2012) [hereinafter: Lapiedra, Palau & Reig]

92. See generally *id.* at 1490.

93. See generally ABELL, *supra* note 59, § 2.5

94. See generally Lapiedra, Palau & Reig, *supra* note 91, at 1492

95. ABELL, *supra* note 59, § 2.5

96. ABELL, *supra* note 59, at 76

97. Lapiedra, Palau & Reig, *supra* note 91, at 1491

due only to its financial strength, but is also heavily influenced by the impossibility of bringing a dispute before a local tribunal.⁹⁸ Likewise, centralization is referenced in the franchise contract and – as a result of concrete contractual provisions – the “franchisor controls a franchisee through direct involvement in the franchisee’s decision-making [what may occur via imposing] opening hours, design and salaries to employees at each station.”⁹⁹ The three groups are clearly related, but should be distinguished. For example, a franchisor seems to be in a superior position, if judged based solely on the concrete provisions of the underlying franchise contract. However, the franchisor might lose out because of the low level of the rule of law in the jurisdiction deciding the franchise-related dispute (e.g., biased or corrupted courts).¹⁰⁰

Even though no laundry list has been compiled of the concrete elements of asymmetry, based on the cases and literature, a fairly complete picture can be canvassed. Starting with the more specific ones, the franchisor’s power to impose arbitration or litigation in a specific jurisdiction based on the most favorable law applicable to the merits as well as various disclaimers¹⁰¹ are routinely used by franchisors. Other inseparable provisions of franchise contracts give the right to inspect, audit, and direct franchisees via consultation or to train, impose standards, control, or tie the supplies, which further augment the control powers of the franchisor.¹⁰² However, more problematic are terms that allow the franchisor to act opportunistically and exploit the strategic advantages “through actions including franchise encroachment, franchise nonrenewal [. . .] and manipulating the supply, advertising, and transfer clauses to capture more of the operational surplus.”¹⁰³

98. Emerson, *supra* note 18, at 105

99. Uri Benoliel, *The Behavioral Law and Economics of Franchise Tying Contracts*, 41 RUTGERS L.J. 527, 533-34 (2010).

100. Bebchuk, *supra* note 31, at 827-28. Similar scenarios could easily be found. Perusing Bebchuk & Posner’s consumer contracts example, “*The existence of a one-sided contract does not imply that the transaction will be one-sided, but only that the seller will have discretion with respect to how to treat the consumer. A seller concerned about its reputation can be expected to treat consumers better than is required by the letter of the contract. But the seller’s right to stand on the contract as written will protect it against opportunistic buyers. A one-sided contract may thus be preferred ex ante by informed parties as a cheaper mechanism for inducing efficient outcomes, should contingencies arise during the performance of the contract, than a more “balanced” contract that, because of imperfect enforcement, could create costs as a consequence of consumers’ enforcing protective provisions in the contract.*”

101. For a list of disclaimers, formulated by and for the benefit of franchisors, see Lagarias, *supra* note 18, at 142-43.

102. For a list of commonly used franchise terms, see Hadfield, *supra* note 26, at 940-43.

103. Larry A. DiMatteo, *Strategic Contracting: Contract Law as a Source of Competitive Advantage*, 47 AM. BUS. L.J. 727, 743, 750-51 (2010), where franchising was referred to as a

Information asymmetry is an inevitable consequence of franchise because every franchise involves the transfer of some intellectual property rights and knowledge together with a tested business pattern and the related expertise.¹⁰⁴ A myriad of tools are ready to be exploited for ensuring uniformity, direct inspection, and audit rights, in addition to the advantages the franchisor has in the negotiation process. Obviously, this type of asymmetry is the one most generally reacted upon given that wherever franchise-specific laws are at place, some type of disclosure or registration is required.¹⁰⁵ Yet informational disclosure could only partially counteract the asymmetric reality.

The hands of the law are essentially tied, however, when faced with the superior strategic position of franchisors, stemming either from their size or financial strength, especially if they are also financing or supplying franchisees with goods or services.¹⁰⁶ This, figuratively speaking, is the issue of the repercussions of a *David versus Goliath-type relationship* legitimizing the handful of cases and claims requesting consumer protection law.¹⁰⁷ The political leverage of American franchise industries and resulting regulatory capture should also be added to the list, even if only glossed over herein.¹⁰⁸

Most of these asymmetries are not *per se* treated by law as unacceptable.¹⁰⁹ Rather the outer boundaries are left to be fixed by courts deciding individual cases.¹¹⁰ For example, it has become a fairly solidified principle that “the more a franchisor controls (as set forth as a right un-

classic example of the use of contract law to create an entirely new means of value creation, an example of strategic contracting to create a private governance structure needed to sustain a long-term relationship.

104. See generally Philip Mark Abell, *The Regulation of Franchising in the European Union* 55 (published thesis, Queen Mary, Univ. of London) (2011).

105. See Abell Thesis, *supra* note 57, at 76.

106. See Steinberg & Lescarte, *supra* note 18, at 59-63.

107. Steinberg & Lescatre, *supra* note 18, at 107 (citing *Postal Instant Press, Inc. v. Sue Sealy*, 51 Cal. Rptr. 2d. 365, 373 (Cal. Ct. App. 1996)). As a US court vividly described: “Although franchise agreements are commercial contracts they exhibit many of the attributes of consumer contracts. 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 . . . 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. [. . .].”; *Contra* see E. Allan Farnsworth, *Contracts* § 4.28 (1999) stating that “[m]any courts . . . have not shared this attitude toward franchisees.”

108. See, e.g., Steinberg & Lescatre, *supra* note 18, at 247-48.

109. See *id.* at 107.

110. See Bebachuk, *supra* note 31, at 830-33.

der the agreement and as actually exercised), the greater risk that a court will find a franchisor is legally an employer or vicariously liable for the franchisee's actions."¹¹¹ Alternatively, courts may hold that an agency relationship exists if the franchisor "in fact has deprived the franchisee of any real independence in operating the business."¹¹² Given the meaningful case law and regulations in the US, no attempt to fix the meaning and limits of asymmetry should start from scratch.

B. On the Unsuitability of Global Contract Theories

Admittedly, meaningful changes have occurred since MacNeil's critique of contract scholarship from 1985 on and the landscape is not dominated by global contract theories (whether centered on promise or else) entirely anymore.¹¹³ As it is quite well-known, UCC Article 2 (or sales law) suffers from being focused on too strongly and linked to concepts like good faith, mistakenly painted with a too wide brush.¹¹⁴ The novelty is that some newer generation contract theories have reached franchise also, though none of them seem to have specifically focused on asymmetry.¹¹⁵ Rather, control and asymmetry are taken for granted and other features seem to have always been given higher priority.¹¹⁶ Three of them will be mentioned briefly just to show that, indeed, none of them seems to have given proper answers to our central dilemmas.

This applies also to the 'balance theory of contracts,' one of the general contract theories originating in 1983 somewhere in Canada,¹¹⁷ the designation of which may misleadingly suggest solutions to our dilemmas. Yet, the theory does not use the attribute of 'balancing' to define what balanced contracts are;¹¹⁸ a position from which one could then pierce the veils from asymmetry. It is rather only an ancillary tool, whereby "the degree" of *voluntariness* and *fairness*,¹¹⁹ as the main pre-

111. LEONARD H. MACPHEE, *Recent Franchise Cases and the Importance of Clear and Complete FDDS and Franchise Agreements*, ASPATORE, June 1, 2013, at 10, available at 2013 WL 3773412.

112. Michael J. Coté, *Franchisor's Liability for Acts of Franchisee*, 39 AM. JUR. PROOF OF FACTS 2D 699 § 3, at 23 (1984).

113. See Ian R. MacNeil, *Relational Contract: What We Do and Do Not Know*, 1985 WIS. L. REV. 483, 508 (1985).

114. See generally *id.* at 508.

115. See generally *id.*

116. *Id.*

117. See Joel Levin & Banks McDowell, *The Balance Theory of Contracts: Seeking Justice in Voluntary Obligations*, 29 MCGILL L.J. 24, 26 (1983-84).

118. See generally *id.*

119. See generally *id.* at 24, 26, that discusses the essence of the theory was "[a] legally binding contract exists where an obligation has been voluntarily assumed, is reasonably fair to the party against whom it is enforced, is consistent with society's contractual expectations, and gives

requisites of valid contracts, are to be adjusted in case of (*inter alia*) contracts “between parties of greatly disproportionate bargaining power.”¹²⁰

Also, the application of the theory’s main formula – according to which “a lack of fairness demands greater voluntariness, and contracts which are less voluntary entered into must be fairer”¹²¹ - would be problematic in case of franchise. Namely, franchise contracts tend to be take-it-or-leave-it type contracts and hardly scholarly examples of fairness because of the high degree of control as materialized to a great degree through asymmetric contractual provisions.¹²² As MacNeil, criticizing the theory, noted “[the notion of voluntariness] presumes the capacity to choose, but choice in exchange transactions and relations, as anywhere else, is by its nature pressured, not voluntary: if one does not assume the obligation, one does not get what one wants.”¹²³ Furthermore, it was of relevance to MacNeil, as it is for us, that the balance theory fails to reach such “basic relational norms [as] balancing power in acceptable ways.”¹²⁴ Yet the theory recognizes also that one should rather think in terms of “some threshold of voluntariness plus some threshold of fairness,”¹²⁵ which, in case of franchise, may coincide with the limits of tolerable asymmetry. The balance theory and franchise asymmetry therefore could be linked.

Hadfield, representative of the theory of incomplete contracts, already departed from franchise as a benchmark contract yet posited the inherent incompleteness at the center observations; at the same time criticizing other approaches not being capable of “satisfactorily strik[ing] the heart of the problem: the incompleteness of the contracts that structure such a complex relationship.”¹²⁶ As such, it is linked to another major US contract theory, the theory of relational contracts, which posits that it is a mistake to determine the content of contractual relationship merely based on the four corners of the document – as it

rise to no administrative difficulties barring enforcement.” Notwithstanding that the theory seems to rest on four prongs, the last two escaped analysis as ‘constants’ “*apply[ing] to all contract situations in just the same way.*” The theory is a general theory of contract even though, as the authors proclaimed, their goal was only to “[specify] what the courts are doing and what they ought to be doing.”

120. *Id.* at 81.

121. *Id.*

122. *Id.* at 30.

123. MacNeil, *supra* note 113, at 503.

124. *Id.* at 503.

125. Levin, *supra* note 117, at 26.

126. *See* Hadfield, *supra* note 26, at 929.

used to be done by classical contract doctrines.¹²⁷ Or, as Hadfield superbly formulates: “[r]elation enters the examination of franchising through the incompleteness of the franchise contract.”¹²⁸ In other words, franchise is particularly suitable for showing how incomplete contracts can be. Perusing the words of Macaulay, a contract law scholar, “the real life of the franchise is found not in the contract but in its operation.”¹²⁹

Admittedly, both theories cast a closer light on the nature of franchise, yet fail to answer our basic dilemmas: what to do with asymmetry and what level of asymmetry should be tolerated? The good and the bad is that the aggregate result of these theories is a general recognition, that in the context of franchise, the economic power, the resulting bargaining positions, and respective vulnerabilities are not to be determined solely based on what the text within “the four corners of the underlying document” says.¹³⁰ The “relation” – “the franchisor’s relative superiority and the franchisee’s relative inexperience”¹³¹ – also matters; perhaps even more than what is hidden in the “text” of the underlying contract itself. A further obvious problem with the incomplete contracts theory is that control – the misbalanced relation – is achieved not only through the unwritten parts of the transaction, but asymmetry introduced through detailed contractual provisions as well.

In Europe, contract theories have hardly been extended to franchise yet. This limit may be ascribed to the less developed and different constellation and orientation of scholars.¹³² Yet, perhaps this is why the analysis of control and asymmetry may prove to be more useful, both practically and theoretically than some of the known classifications and tests of franchise contracts, like the classification of the German scholar, Martinek based on “the balance of power and alignment of interests

127. See Gillian K. Hadfield, *Problematic Relations: Franchising and the Law of Incomplete Contracts*, 42 Stan. L. Rev. 927, 929 (April 1990).

128. *Id.* at 956.

129. Stewart Macaulay, *Law and the Balance of Power: The Automobile Manufacturers and Their Dealers* (Russell Sage Foundation, 1966); cited by Hadfield *supra* note 26, at 957. See Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOCIO. REV. 1, 5-7 (1963). Macaulay found empirical evidence that suggests only large corporations transacting with large sums of money rely on detailed and carefully negotiated contracts. Rather, transactions are more frequently based on what Macaulay dubbed “standardized planning,” that is, standardized terms, conditions, and clauses. Here, it is often the case that the involvement of lawyers and law is undesirable to businessmen that would rather “keep it simple and avoid red tape.”

130. See Hadfield, *supra* note 26, at 956.

131. *Id.* at 961.

132. See generally MARK ABELL, *THE LAW AND REGULATION OF FRANCHISING IN THE EU* (Elgar, 2013).

between the parties.”¹³³ Martinek differentiates ‘subordination’ and ‘partnership’ franchising: the first being characterized by a hierarchical relationship between the parties and the latter being the antithesis of the former (as further sub-divided into three categories).¹³⁴ The problem with the classification is that it only depicts and explains; though indirectly recognizing how crucial imbalance is. Moreover, as Abell proved, the categorization is not reflected in actual agreements (which tend to be rather of mixed nature.)¹³⁵ Most importantly, it does not offer an answer to our query of what level of asymmetry should be tolerated? Albeit it dissects to a certain extent asymmetry, it fails to answer concretely what it is made of. Using again the right of encroachment as a concrete element of asymmetry, Martinek’s classification fails to answer whether it should be taken into account when defining asymmetry and its limits.¹³⁶

C. What Monist versus Pluralist Normative Theories Could Offer

As the widespread use, international success, and some contract theories, directly or indirectly, corroborate: asymmetry is a key feature of the business format franchise - the success story of our times. The legitimacy of franchise asymmetry should thus go uncontested. With this presumption in mind, the next logical step would be to justify it and state what the law should say on franchise asymmetry. Or, referring back to our initial question, what the tolerable level of asymmetry should be in case of paradigm franchise transactions? Multiple benefits would ensue from such an asymmetry-fitting normative theory. It would not only make “possible to justify and criticize laws soundly [to] undergird the legal system’s legitimacy,”¹³⁷ but would make the nomination of franchise possible as well. Ultimately, this would enhance predictability and protection of weaker parties. If for nothing else, the theory is needed to justify what has already been going on in all the jurisdictions hosting modern business format businesses.

The limits of this paper do not allow for the development of a full-scale normative theory. Still, two general conclusions lend themselves to be formulated even based on the hereinbefore elaboration. On the one hand, it should be clear that asymmetry, so expressed in the context of franchise, is hardly replicated in the case of other contracts. The logical

133. See Martin Martinek, *Moderne Vertragstypen*, Vol. II, Chapter IV on Franchise (C.H. Beck’sche Verlagsbuchhandlung, München 1992). Quotation from ABELL, *supra* note 59, at 50.

134. See ABELL, *supra* note 59, at 76-77

135. *Id.* at 54.

136. *Id.* at 20, 76.

137. See ABELL, *supra* note 59, at 75-81.

conclusion is thus that franchise is a *sui generis* paradigmatic asymmetric contract, a feature playing a much less important role in case of other contracts. As it is known, this may lead to one form of “pluralism through contract types.”¹³⁸ This inevitably reshuffles classical presumptions that were based on sales and other model contracts, let alone single-metric unification theories. Franchise asymmetry simply requires a normative theory of its own even though not fully fitting under established global and other more specific theories. On the other hand, due to the complexity and relational nature of franchise, as exacerbated by the multitude of possible types of franchises, a single-value theory could hardly fill the void. More values stand ready to justify asymmetry in the franchise context, such as efficiency, increased predictability, administrability, more consistent adjudication, and others. Consequently, franchise asymmetry is an ideal target for a pluralist theory.

V. CONCLUSION

This article had a simple mission: to unearth what asymmetry in the case of franchise consists of (i.e., is it a *sine qua non* element of franchise contracts?), and could it be justified by contract theory? As a largely bypassed topic, more questions than answers characterize these pages. Still, it would be a mistake not to see the conclusions that virtually offer them to be formulated. First, not only the very existence, robust economic role, and international success of franchise, but also venerable contract theories prove the existence of franchise asymmetry. Even the farthest-reaching franchise relationship laws in some American states do not aim to eliminate it through imposed rebalancing. Rather, they only try to shield the inherently weaker franchisee with increasingly more efficient legal tools in order to prevent franchisor abuses and overreach.¹³⁹ This is just further proof. Put simply: franchise asymmetry is given, is omnipresent, and is tolerated to differing yet unarticulated degrees even by rudimentary laws.

Secondly, notwithstanding the increasing regulatory intervention, asymmetry has remained primarily a contract law issue. However, contract theory, blinded to mainstream myths, seems to have failed to face it specifically. The reasons and the repercussions of the failure differ on the two sides of the Atlantic (and beyond), but the number of common concerns is meaningful, especially as the business model at the center is one and the same. It is propounded here, subscribing to the view of

138. See Roy Kreitner, *The Future of Contract Theory: On the New Pluralism in Contract Theory*, 45 Suffolk U. L. Rev. 915, 920 (2012).

139. E. ALLAN FARNSWORTH, *CONTRACTS* 533-34 (Apen Pub., 4th ed., 2004).

Hadfield, that the basic question of whether contract law has a task related to franchise asymmetry should be answered in the affirmative.¹⁴⁰

Thirdly, it is presumed here that asymmetry can be defined and delimited not only on an abstract plain. A seminal, fool-proof model has been offered based on standard franchise-specific contract terms and their treatment by the law and courts. Franchise contracts are sufficiently standardized to allow for compiling of such a list of franchise-specific asymmetric clauses (with the sub-variants of each) based on a test of which, “fair asymmetric franchise contracts” could be extrapolated.

Fourthly, as hopefully amply illustrated above, the “asymmetry puzzle” has practical repercussions for both Europe and the US. Given the unusually strong trans-national dimensions of franchise, it is not far-fetched to claim that harmonization would not just be possible, but will be inevitable very soon. From this perspective, the role of contract theory is more than academic. Part of the problem seems to be that contract theory is dominated by global theories, trying to forge all-fitting doctrines. As life has not become simpler compared to the 1960s, MacNeil’s caveat – that such global theories “decrease rather than increase our knowledge of relations”¹⁴¹ – seems to be more than appropriate today and in the context of franchise.

Last but not least, there exists a common gap in contract theory in all developed franchise systems which is: the lack of a proper answer to what asymmetry is concretely made of and what level of franchise asymmetry should be tolerated. Or, referring back to our initial Polish case, one could hardly point to a law or scholarly paper to easily and unequivocally answer the issues faced by the Polish judge.

The key lesson underlying the discourse on franchise asymmetry is that contract theory could ease the tensions by formulating, if not an acid test, than at least a benchmark, that would provide more guidance than the *ad hoc* context-specific answers of courts and the extreme variety of imperfect ambulatory regulatory responses. This requires concluding, similarly to MacNeil’s caveat on relational contracts made in 1985, that: “We can and we shall learn a great deal more *about*” asymmetric contracts.¹⁴²

140. Hadfield, *supra* note 26, at 928.

141. See MacNeil, *supra* note 113, at 508.

142. *Id.* at 525.