Good Cause for Franchise Termination: An Irreconcilable Difference Between Franchisee Fault and Franchisor Market Withdrawal?

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I. INTRODUCTION

Once limited to the fast-food and hotel industries, franchising is now big business in the United States. Collectively, franchise outlets employ more than 7.2 million people and sell approximately $600 billion annually in goods and services.¹ In 1990 franchises accounted for thirty-four percent of retail sales in the United States.² The number of franchise outlets has grown from approximately 200,000 in 1960 to approximately 465,000 in 1990.³ These figures reflect the significant role franchising now plays in our national economy reform, a role which has led to statutory reform.

Until the mid-1970s, common law contract doctrine governed the franchisor-franchisee relationship. The franchisor could lawfully terminate the franchise relationship when the franchise contract expired or when the franchisee breached any contractual provision.⁴ Termination essentially caused the franchisee to forfeit her investment, except for equipment, supplies, and inventory that had already been purchased, and it allowed the franchisor to regain full control of the franchise.⁵ Moreover, the franchisee was not compensated for the value of her business, while the franchisor was free to begin a relationship with a new franchisee.

The application of common law contract doctrine to franchise agreements was modified during the 1970s as allegations

2. Franchising in the U.S. Economy: Hearing Before the House Comm. on Small Business, 101st Cong., 2d Sess. 51 (1990). By 2000, franchising is expected to account for half of all retail sales. Id. at 97-98.
5. Id. at 467 n.5.

785
of franchisor abuse reached legislators’ receptive ears. Many states enacted legislation to correct the perceived disparity in bargaining power between franchisors and franchisees and to prevent unjust enrichment of the franchisor. These franchise relationship statutes allow termination only for “good,” “just,” or “reasonable” cause, which is generally defined as the franchisee’s failure to reasonably or substantially comply with the terms of the franchise agreement. Thus, the good cause standard has taken away the franchisor’s unilateral right to determine its franchisee’s compliance with the agreement and has placed the burden on the judiciary to resolve what constitutes satisfactory performance by the franchisee.

This comment examines the impact of the good cause standard on two areas of termination litigation: franchisee failure

6. Legislative hearings revealed such abuses by franchisors as refusal to renew viable franchises, leaving the franchisee with nothing for her investment. “Others have threatened franchisees with termination to coerce them to stay open at unreasonable hours, purchase supplies only from the franchisor and at excessive rates or unduly expand their facilities.” Westfield Centre Serv. v. Cities Serv. Oil Co., 432 A.2d 48, 53 (N.J. 1981).


Even if a state does not have a general franchise law, it may have legislation governing automobile, gasoline, liquor, or farm implement dealerships. See Raymond King, Comment, Fairness in Franchising: The Need for a Good Cause Termination Requirement in California, 13 U.C. Davis L. Rev. 780, 803 n.100 (1980).


to comply with the financial terms of the agreement and franchisor market withdrawal. Section II considers how a statutory good cause definition protects the franchisee following the franchisee's breach. Section III presents a case study of an area generally outside statutory good cause—franchisee termination resulting from a change in the franchisor's marketing strategy—and demonstrates how termination legislation considers only the interests of the franchisee. Section IV concludes that the state legislatures should reconsider their franchise termination legislation by recognizing and protecting the legitimate interests of both the franchisor and franchisee.

II. FRANCHISEE FAILURE TO COMPLY WITH FINANCIAL TERMS

Without referring to a state franchise statute, a franchisor may assume that its franchisee's failure to comply with the financial terms of the agreement, such as reporting sales accurately or paying royalties on time, constitutes sufficient grounds for termination without violating the state's good cause statute. However, depending upon the statutory good cause definition, this assumption may not be confirmed by a court, as the following cases show. This section examines how the judiciary applies the good cause standard by focusing on the relationship between the parties' conduct, the good cause definition, and public policy.

A. Indiana's Hacienda Case: No Shelter for the Franchisee

In *Hacienda Mexican Restaurant of Kalamazoo Corp. v. Hacienda Franchise Group, Inc.* 10 the franchisor terminated its franchisees for defaulting on royalty payments. According to the terms of the franchise agreement, the franchisor had the unilateral right to terminate the franchisees upon three defaults in any eighteen-month period, without giving the franchisees notice or an opportunity to cure.11 The franchisees defaulted by making three late royalty payments between January and March 1990, approximately three months after their franchise-restaurant opened.12 In each instance the franchi-

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11. *Id.* at 667.
12. *Id.* at 665.
sees paid their royalties at least seven days later than the payment due date. When the third royalty payment was not timely paid, the franchisor notified the franchisees that their agreement was terminated because of the three defaults. The franchisees brought their royalty payments current and continued operations; however, the franchisor sued and was granted a preliminary injunction enjoining the franchisees from operating the franchise-restaurant.

On appeal to the Indiana Court of Appeals, the franchisees claimed that termination for late royalty payments was an economic reason and thus not "good cause" as defined by the Indiana Deceptive Franchise Practices Act and as interpreted by the Seventh Circuit in Wright-Moore Corp. v. Ricoh Corp. The court, however, rejected the franchisees' argument and affirmed the injunction. The court recognized that the Indiana statute permitted contractual provisions allowing unilateral termination for good cause and that the statute did not limit good cause to material violations. Without addressing whether the payment defaults were material violations, the court concluded that the franchise agreement did not permit termination absent good cause.

The court then distinguished Wright-Moore's finding that the franchisor's internal economic reasons could not constitute good cause for termination. In Wright-Moore, the franchisee, Wright-Moore, had not breached its agreement with Ricoh; thus, Ricoh's decision to terminate Wright-Moore based on Ricoh's new marketing strategy did not fall within the statute's plain language. In Hacienda, the franchisees had breached

13. Id.
14. Id.
15. Id.
16. IND. CODE ANN. § 23-2-2.7-1(7) (Burns 1989) states that it is unlawful for a franchise agreement to "permit[] 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."
17. 908 F.2d 128 (7th Cir. 1990). Ricoh refused to renew Wright-Moore's national copier dealership agreement because of a change in Ricoh's marketing strategy to regional distributorships. The Seventh Circuit held that "the internal economic reasons of the franchisor are not, by themselves, good cause for termination or nonrenewal of a franchise." Id. at 137. Although Indiana Code § 23-2-2.7-1(8) specifically addresses nonrenewals, the Seventh Circuit interpreted the case under § 23-2-2.7-1(7) which governs terminations, perhaps because § 23-2-2.7-1(8) does not define good cause.
19. Id.
20. Id.; see Wright-Moore, 908 F.2d at 138 ("[T]he statute may be limited
the agreement by defaulting three times; "therefore [the franchisor] demonstrated that it had properly terminated the franchise agreement." 21

The court's reasoning illustrates how good cause may be an empty phrase which inadequately protects the franchisee's interests. 22 According to the court's reasoning, the statute allows the franchisor to define the standard for termination in the contract, a definition which the court will uphold if it meets the "good cause" test. Since good cause includes, but is not limited to, material violations, the court will conceivably never have to define materiality. Essentially the franchisor will be able to terminate its franchisee without judicial interference as long as the contract allows for termination when the franchisee fails to comply with a provision, regardless of its substance. The Indiana Court of Appeals seems to be permitting what the Seventh Circuit in Wright-Moore sought to prevent—termination for any business reason in the interest of the franchisor. 23 Thus, assuming that the purpose of the Indiana termination statute is to protect franchisees from unfair treatment by franchisors, 24 franchisee protection under the statute is minimal.

B. Illinois's Great American Cookie Case: Protecting the Franchisee

Five months after the Indiana Court of Appeals issued its opinion in Hacienda, an Illinois federal district court was presented with a similar question in Original Great American Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd. 25 In this case, the franchise agreement allowed termination upon

\[\text{to} \ldots \text{problems with the performance of the franchisee.}^\text{2).} \]


22. Given the importance of timely payments to any business's cash flow, the court reached the correct result in Hacienda. However, its refusal to consider materiality does not establish a favorable precedent for franchisees.

23. See Wright-Moore, 908 F.2d at 137-38. Some protection is afforded the franchisee because the grounds for unilateral termination must be contained in the contract. However, given the franchisor's ability to insist on contract terms favorable to her position, the protection is limited.

24. The Seventh Circuit in Wright-Moore acknowledged that Indiana's franchise law has no legislative history and that it interpreted Indiana's law by reference to the purposes behind similar laws in other states. The court referred to the Wisconsin Fair Dealership Law's purpose "to protect dealers against 'unfair treatment' from franchisors who 'inherently have superior economic power and superior bargaining power.'" Id. at 135 (citation omitted).

three contractually defined material breaches, or defaults, during a twelve month period.26 One contractually defined default was failure to pay an invoice within ten days of its due date.27 Great American issued two notices of default in February and June of 1990 for four invoices totalling approximately $12,350, which were 19, 35, 33, and 38 days overdue.28 The third default, which triggered termination, occurred when an independent audit revealed that River Valley had underreported its sales during 1987 and 1988 by $40,551, resulting in additional royalties due Great American of $2,839.29

Although River Valley promptly paid the additional royalties, Great American terminated its franchise in October 1990; however, River Valley continued to sell cookies, even when it ran out of Great American batter in February 1991.30 Great American filed suit, alleging unauthorized use of its trademark and breach of contract. River Valley counterclaimed, alleging that Great American violated the Illinois Franchise Disclosure Act (IFDA)31 by improperly terminating its franchise.32 Both parties sought preliminary injunctions, and the district court granted such relief to River Valley by ordering Great American to comply with the terms of the franchise agreement.33

In arriving at its decision, the court first analyzed River Valley's alleged repeated defaults34 in light of the good cause

26. Id. at 1125.
27. Id. at 1126.
28. Id. at 1126-27, 1129. This figure does not include invoices for amounts under $100 which the court viewed as inconsequential. Id. at 1129.
29. Id. at 1125.
30. Id. at 1124.
31. ILL. ANN. STAT. ch 121 1/2, para. 1719 (Smith-Hurd Supp. 1991). Termination of a franchise except for "good cause" violates the statute. "Good cause" is defined according to whether notice and an opportunity to cure a default is required. In this case, the court applied ¶ 1719(c)(4): "'Good cause' shall include, but without the requirement of notice and an opportunity to cure, situations in which the franchisee . . . repeatedly fails to comply with the lawful provisions of the franchise or other agreement."
33. Id. at 1130.
34. Id. at 1127-29. In addition to the three financial defaults, Great American presented evidence of two other defaults. In 1989, River Valley failed to name Great American as an additional insured. However, because Great American offered River Valley an additional franchise eight months later, the court downplayed the event while stating that it could be good cause. The second default concerned River Valley's failure to adhere to standards of cleanliness and product quality. While acknowledging that such failure would be grounds for termination, the court disregarded the event because Great American had never notified River Valley that its operation fell below acceptable standards and constituted a default. Id. at 1127.
standard interpreted in *Dayan v. McDonald’s Corp.* Dayan “held that ‘good cause’ means ‘failure to substantially comply with obligations under the agreement’ and centers on a ‘determination of commercial reasonability.’” The court first applied the commercial reasonability standard to the $2,839 underpayment of royalties on sales in excess of $1 million over a three-year period, finding that the underreporting constituted one default instead of a default for each month the sales were underreported. The court concluded that this underreporting could be a basis for “good cause” termination.

The court then evaluated the late invoice payments and declared that “a contract provision allowing a business to declare a default (potentially resulting in forfeiture of the entire business) for failure to pay an invoice within ten days is [not] commercially reasonable.” Since the provision was commercially unreasonable, River Valley’s two failures to timely pay invoices could not constitute good cause for termination under the contract. Thus, with only two possible “good cause” bases left for termination, the court determined that River Valley would likely prevail on its claim that Great American’s attempted termination of its franchise was without good cause in violation of the IFDA.41

*Great American* illustrates the difference that a state’s good cause definition makes. In *Hacienda*, the Indiana Court of Appeals permitted termination of the franchise relationship for three late royalty payments, but in *Great American* the federal district court found that ten-day late invoice payments were not good cause for termination under Illinois law. According to the *Great American* court, Indiana law allows good cause to include nonmaterial breaches whereas Illinois law, as inter-

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35. 466 N.E.2d 958 (Ill. Ct. App. 1984). In *Dayan*, the Illinois Court of Appeals upheld McDonald’s Corp.’s termination of Dayan’s Paris franchises for noncompliance with the cleanliness and quality standards required by the franchise agreement. See id. at 976.


37. *Id.* at 1128-29.

38. *Id.* at 1129. In determining the significance of the underreporting, the court also considered that only one small error had been found the year preceding the audit. *Id.*

39. *Id.* The court determined that “Great American’s draconian provision . . . is not even arguably reasonable” even though neither party presented any evidence regarding business practices in paying debts. *Id.* at 1129 n.11.

40. The two bases were underpayment of royalties and failure to name Great American as an additional insured. See *supra* note 34.

41. *Id.* at 1129.
interpreted by Dayan, limits good cause to material breaches.\textsuperscript{42} Ironically, the IFDA did not apply to Dayan;\textsuperscript{43} nevertheless, federal courts applying Illinois law have continued to use Dayan’s commercial reasonability test in the few cases litigated.\textsuperscript{44} Also, in contrast to Indiana law, the federal courts’ adoption of a commercially reasonable standard furthers the public policy of the IFDA “to protect the franchisee.”\textsuperscript{45} This standard affords more protection to the franchisee than Indiana’s definition of good cause because the court may look to business practices outside the contract’s four corners to determine the fairness of the franchisor’s actions.

III. FRANCHISOR MARKET WITHDRAWAL

As shown by the cases in Section II, a court’s interpretation of the good cause requirement necessarily focuses on the franchisee’s failures and deficiencies under the franchise agreement. What happens when the franchisor’s economic circumstances, rather than the franchisee’s performance, are the cause for termination? State statutes do not address those situations in which a franchisor terminates its franchisees because of a system-wide change in its marketing strategy or its withdrawal from a geographic market area.\textsuperscript{46} As might be expected when statutory guidance is unclear, the judicial opinions in the marketing strategy\textsuperscript{47} and market withdrawal\textsuperscript{48}

\begin{itemize}
  \item Id. at 1129 n.11.
  \item Dayan, 466 N.E.2d at 973. Although the Illinois legislature did not give the IFDA retroactive application, the IFDA was “relevant as an embodiment of applicable public policy” that a franchise may not be terminated unless good cause exists. Id. The court defined good cause in the course of resolving the actual issue on appeal, whether McDonald’s Corp.’s termination violated the implied covenant of good faith.
  \item See, e.g., Dayan, 466 N.E.2d at 973. The legislature wanted to protect franchisees from long-standing abuses, particularly the franchisor’s broad unilateral power of termination at will. Id. The court in Great American described the policy objectives as “prohibit[ing] franchisors from terminating franchisees without good cause.” Great American, 773 F. Supp. at 1130.
  \item But cf. 15 U.S.C. § 2802(b)(2)(E) (1988) (permitting franchisors “in good faith and in the normal course of business to withdraw from the marketing of motor fuel through retail outlets in the relevant geographic market area”).
  \item Cases which have found good cause requirements to be satisfied include: American Mart Corp. v. Joseph E. Seagram & Sons, 824 F.2d 733 (9th Cir. 1987) (nationwide change to exclusive distributorships); Bimel-Walroth Co. v. Raytheon Co., 796 F.2d 840 (6th Cir. 1986) (nationwide combination of product line distribu-
\end{itemize}
cases lack uniformity. The lack of uniformity is best illustrated by the nationwide litigation following General Motors Corporation's 1986 decision to withdraw from the heavy duty truck market. The GMC opinions are particularly interesting because of their "contradictory interpretations of essentially similar factual and legal questions." Following an examination of the various GMC courts' reasonings, this section attempts to reconcile the conflicting results.

A. Background of the GMC Cases

General Motors Corporation (GMC) entered into agreements granting dealers the non-exclusive right to hold a dealership out as an authorized GMC truck dealer and to buy trucks, parts, and accessories as described in the addenda attached to the agreement. Each dealer signed separate addenda for different truck models: light duty, medium duty, and heavy duty. GMC retained the right in the agreements to "discontinue any


product at any time."

On August 15, 1986, GMC signed a memorandum of understanding with AB Volvo and its American subsidiaries, including Volvo White. The parties agreed to enter into a joint venture, known as Volvo GM Heavy Truck Corporation. GMC was to withdraw from the North American heavy duty truck market as of January 1, 1987, and in GMC’s place, Volvo GM would manufacture and market heavy duty trucks under the trademark “White GMC.” Both Volvo and GMC agreed to terminate their approximately 530 existing dealerships and to establish a new network of approximately 240 dealers, selecting one of their previous dealers where possible.

Between September and November 1986, GMC notified all of its dealers that production of its heavy duty trucks would be discontinued. If the dealer was not subsequently offered a Volvo GM franchise, GMC canceled its heavy duty truck addendum, effective December 31, 1987. GMC, however, did not cease to manufacture all of its heavy duty trucks. Pursuant to a contract with Volvo GM, GMC continued to manufacture one model, the Brigadier, for one year following its withdrawal from the heavy duty truck market.

The plaintiffs in the resulting litigation were dealers who did not receive a franchise offer from Volvo GM. Each dealer brought suit alleging wrongful termination of a franchise under state laws regulating motor vehicle dealerships; the only suits brought under a state general franchise relationship statute were in New Jersey.

B. Verdict: GMC Dealerships

1. Wisconsin: GMC did not nondiscriminatory withdraw from the market

In *Mid-State Truck Service v. General Motors Corp.*, the
district court granted Mid-State's motion for summary judgment, finding that GMC had canceled Mid-State's franchise in violation of Wisconsin law.\(^{55}\) GMC unsuccessfully argued that its complete nondiscriminatory withdrawal from the heavy duty truck market did not violate the statute.\(^{56}\) Although GMC had withdrawn from the market to the extent that it ceased manufacturing three of the four heavy duty truck models listed in Mid-State's addendum, GMC had not totally withdrawn from the market because it continued to produce the Brigadier model for sale by the joint venture.\(^{57}\)

Although willing to hold that GMC's nondiscriminatory product withdrawal did not violate the statute, the court found that GMC itself had not nondiscriminatorily withdrawn from the market.\(^{58}\) The court's finding relied entirely on GMC's continued manufacture of the Brigadier model.\(^{59}\) The court then concluded that GMC's cancellation of Mid-State's franchise with respect to the Brigadier model was "unfair" and "without just provocation" as defined by Wisconsin law.\(^{60}\) In addition to granting Mid-State's summary judgment motion on its statutory claim, the court entered an injunction requiring Volvo GM to continue Mid-State's franchise in the Brigadier model.\(^{61}\)

2. Maine: Extent of GMC's participation in joint venture raises questions

In *C-B Kenworth, Inc. v. General Motors Corp.*,\(^{62}\) the court denied GMC's motion for summary judgment on Kenworth's claims that GMC's termination of its franchise violated the Maine Motor Vehicle Dealer's Act.\(^{63}\) The Act prohibits termi-
nation absent good cause and provides that good cause exists when "the manufacturer discontinues production or distribution of the franchise product." Good Cause Requirement

GMC argued that it fulfilled the good cause requirement because it discontinued production and distribution of its heavy duty trucks when it entered into the joint venture with Volvo White. Kenworth, however, disputed GMC's claim, alleging that GMC had continued to manufacture the Brigadier as well as perform warranty work on and make parts for heavy duty trucks. Kenworth also claimed that because GMC exercised significant control over the joint venture, it had not "departed from the heavy duty truck market." While acknowledging that it continued to make the Brigadier, GMC claimed it still had departed from the market because the joint venture, which GMC denied controlling, marketed the Brigadier and its parts. The court rejected GMC's argument, finding that Kenworth had introduced enough evidence to raise a genuine factual question on whether GMC had good cause to terminate its franchise.

3. New York: GMC's incomplete market withdrawal raises genuine questions

In Arthur Glick Truck Sales v. General Motors Corp., the Second Circuit reversed the district court's grant of summary judgment to General Motors. The district court found that "no franchise had been terminated" by reasoning that the statute did not require a franchisor to continue manufacturing an unprofitable product line because commerce would be adversely affected. The Second Circuit characterized this rationale as "purely economic" and criticized the district court for failing to consider that heavy duty trucks might constitute a separate franchise under New York law. The district court also failed to account for GMC's continuing manufacture of the successful Brigadier model for marketing by the joint venture.

provision requiring good cause.
64. Title 10, § 1174(3)(P)(4).
66. Id.
67. Id.
68. 865 F.2d 494 (2d Cir. 1989).
69. Id. at 497.
70. Id.
71. Id. The Second Circuit in its statement of facts noted that in 1987 the Brigadier model accounted for 71.52% of GMC's heavy duty truck sales and that
Since the district court found no franchise termination, it did not reach the question of whether GMC had terminated Glick's franchise without due cause in violation of the Franchised Motor Dealer Vehicle Act. The Second Circuit found that there were genuine issues of fact regarding GMC's termination of Glick's franchise, given its incomplete market withdrawal. However, the court did not provide any guidelines as to which, if any, of GMC's reasons for termination would constitute due cause.

4. New Jersey, Round 1: GMC's market withdrawal violates statute per se

In *General Motors Corp. v. Gallo GMC Truck Sales*, a federal district court granted Gallo's motion for summary judgment on its claim that GMC's termination of its franchise lacked good cause under the New Jersey Franchise Practice Act (NJFPA). The court, interpreting the plain language of the statute, held that the only "good cause" for termination is the franchisee's failure to substantially comply with the terms of the franchise agreement; the franchisor's actions in good faith or for bona fide economic reasons do not absolve it of liability under the Act.

The court supported its interpretation of the NJFPA by referring to other New Jersey court decisions and the NJFPA's purpose. The legislature, recognizing past abuse of the franchise relationship through the franchisor's superior bargaining position, sought to prevent arbitrary termination of franchisees. Because there was no good faith exception in

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72. N.Y. VEH. & TRAF. LAW § 463(2)(d)(1) (McKinney 1986) states that "[i]t shall be unlawful for any franchisor to terminate, cancel or refuse to renew the franchise of any franchised motor vehicle dealer except for due cause, regardless of the terms of the franchise." Due cause is not defined in the Act.
73. *Arthur Glick*, 865 F.2d at 498.
75. N.J. STAT. ANN. § 56:10-5 (West 1989). Good cause is "limited to failure by the franchisee to substantially comply with those requirements imposed upon him by the franchise." *Id.*
the statute, the court concluded that "it was not the intent of the New Jersey legislature to protect the business interests of the franchiser [sic]." Given the NJFPA's purpose and its limitation of good cause to substantial breaches by the franchisee, the court found that GMC's termination of Gallo's franchise due to its withdrawal from the heavy duty truck market lacked good cause.

C. Verdict: GMC

1. Massachusetts: Volvo White had "sound economic reasons"

In General GMC, Inc. v. Volvo White Truck Corp., General GMC's request for a temporary restraining order enjoining Volvo White from terminating its dealership was denied. The court found that Volvo White had good cause for termination under Massachusetts law because of "legitimate business reasons"—it would have been defunct by January 1, 1988. The court also explained that Massachusetts law did not prevent a manufacturer from making business decisions "predicated on sound economic reasons." Although the court did not elaborate on the economic reason behind the formation of the Volvo White/GMC joint venture, it was probably referring to Volvo White's difficulty in competing profitably in the American heavy duty truck market.

79. Id. at 818.
80. [1987-89 Transfer Binder] Bus. Franchise Guide (CCH) ¶ 9178, at 19,153 (D. Mass. 1987), rev'd in part, 918 F.2d 306 (1st Cir. 1990). Following General GMC's defeat on its motion for a temporary restraining order, the district court granted Volvo White summary judgment. The First Circuit reversed summary judgment with respect to General GMC's state statutory claim that Volvo White acted in bad faith when it considered General GMC for a Volvo GM dealership. 918 F.2d at 308-09. Since the subsequent case history does not concern Volvo White's withdrawal from the market, this section discusses only General GMC's motion for a temporary restraining order.

General GMC was a dealer for Volvo's American subsidiary, Volvo White; except for the defendant's name, the facts in the text accompanying notes 50-53 are the same. Besides GMC's Brigadier model, Volvo GM also had plans to sell one of the two existing heavy duty Volvo White models under the joint venture. [1987-89 Transfer Binder] Bus. Franchise Guide (CCH) at 19,155.

81. MASS. GEN. L. ch. 93B, § 4(3)(e) (1984). Termination of a motor vehicle dealer's franchise without good cause is an unfair or deceptive act and is unlawful. Id. Section 4(3)(e)(4) requires the court to consider "all pertinent circumstances" in determining whether good cause has been established.

83. Id. at 19,157.
84. Id. at 19,155. Volvo White had only a 10% share of this highly competitive
The court's analysis of good cause focused on Volvo GM's selection of franchisees for the new joint venture. Volvo GM's decision to terminate General GMC's franchise was based on the change in product lines as well as an assessment of the area's inability to support multiple dealerships. The court characterized this "legitimate business decision" as a change in the "channels of distribution" which "an automobile manufacturer has an unqualified right to make." These legitimate business reasons, supported by Volvo White's defunct status, met the good cause requirement.

2. Pennsylvania: GMC's motives for joint venture constituted "good cause"

In C. Earl Brown, Inc. v. Commonwealth, the court affirmed the finding of the State Board of Vehicle Manufacturers, Dealers and Salespersons (Board) that General Motors did not revoke the Pennsylvania Board of Vehicles Act when it withdrew from the heavy duty truck market. Brown argued that GMC had not exited the heavy duty truck industry but merely continued its operations in a different corporate form. The court refused to follow Brown's argument that anything less than a total cessation of business violates the Act because the Act itself allows a manufacturer to prove that its termination decision was for good cause and in good faith.

Because of the "good faith and good cause" language, the Board examined GMC's motives for termination. The Board found that GMC's initial decision to form the joint venture was made for good cause "because [GMC] was rapidly losing its market share and could not afford to make the large capital investments that would be required to build its position."

85. Id. at 19,156.
86. Id.
88. PA. STAT. ANN. tit. 63, § 818.9(c) (Supp. 1984) (amended 1991) provides that a manufacturer violates the Act when it cancels a vehicle dealer's franchise "unfairly, without due regard to the equities of said dealer and without just provocation." Prior to 1991, the section also provided that if a dealer appeals its termination to the State Board of Vehicle Manufacturers, Dealers and Salespersons, the manufacturer had the burden "to show that such termination ... was for good cause and in good faith." Id.
89. Brown, 555 A.2d at 316.
90. Id. at 316-17.
91. Id. at 317. The Board had found that GMC's market share in 1985 was
The Board also found good faith because neither GMC's nor Volvo's conduct was dishonest. The court acknowledged that it was difficult, if not impossible, to separate GMC's joint venture decision from its resulting decision to terminate Brown's franchise. Therefore, given that GMC's initial decision to form the joint venture was for good cause and in good faith, the court sustained the Board's finding that Brown's franchise had not been illegally terminated.

3. North Carolina: GMC's discontinuance of product line constituted "good cause"

In Carolina Truck & Body Co. v. General Motors Corp., the North Carolina Court of Appeals upheld the determination by the North Carolina Commissioner of Motor Vehicles that GMC terminated Carolina Truck's franchise for good cause and in good faith under North Carolina law. Since the statute limits good cause in part to a dealer's failure to comply with the contract, it appears that a manufacturer's market withdrawal is not good cause for termination. Therefore, in order to find good cause for GMC's actions, the court had to look beyond the statutory language.

The court began by noting that the "good cause" section, 20-305(6), cross-references and includes section 20-305(6)(c)(1)(IV), which defines the notification period for termination as 180 days "where the manufacturer or distributor is discontinuing the sale of the product line." Interpreting the statute in pari materia, the court held that "the statute... provides that a manufacturer may cancel a franchise if discontinuing the sale of the product line and that this action is for
'good cause.'" Furthermore, the court refused to believe that the North Carolina legislature would 'require a manufacturer to continue on a road to certain bankruptcy by requiring the manufacturer to continue to make and sell unprofitable models of cars or trucks.'

After finding that discontinuance of a product line is good cause for termination, the court concluded that the evidence documenting GMC's loss of profits in the heavy duty truck market supported the trial court's finding of good cause. It further found that GMC terminated Carolina Truck's franchise in good faith because GMC did not act dishonestly, GMC gave Carolina Truck a year's notice, and GMC treated Carolina Truck the same as its other heavy duty truck franchisees.

4. Maryland: GMC did not abuse its superior bargaining position

In Central GMC, Inc. v. General Motors Corp., the Fourth Circuit reversed the district court's $2 million award to Central GMC for wrongful termination under Maryland law. Although the Fourth Circuit reversed on the grounds that the separate addenda did not constitute a franchise, the court discussed the purpose of the Maryland statute and its application to GMC's withdrawal from the heavy duty truck market.

The court first considered the Maryland Act's purpose to prevent "'frauds, discrimination and other abuses' in the manufacturer/dealer relationship." Clearly the statute intended to prevent domineering behavior by the franchisor because of its greater bargaining power. Central argued that GMC's joint venture was an illegal abuse of power because GMC had not withdrawn from the market—GMC continued to

100. Id.
101. Id. The trial court described GMC's nationwide withdrawal as a "reasonable and justifiable business decision." Id. at 136.
102. Id. at 138.
104. Md. Transp. Code Ann. § 15-209(a)(1) (1987) states that a manufacturer may not terminate a dealer's franchise unless "the dealer has failed to comply substantially with the reasonable requirements of the franchise." The statute does not make an exception for actions in good faith or for good cause.
105. "GMC has discontinued a product but has not terminated a franchise." Central GMC, 946 F.2d at 332.
106. Id. (citation omitted).
manufacture the Brigadier for a year after its supposed withdrawal. As further proof of GMC's market presence, Central pointed to "the inclusion of 'GMC' in the brand name of the joint venture's trucks; . . . mandatory compatibility of the joint venture's truck engines and transmissions with those produced by a General Motors division; and GMC's right to elect a portion of the joint venture's board of directors." GMC responded with facts that demonstrated its limited participation in the joint venture. The court refused to resolve the "hornet's nest" because GMC's decision to cease producing heavy duty trucks was a "legitimate, lawful reaction . . . to unfavorable market conditions" and was not "an abuse of superior bargaining power" which ran afoul of the Maryland statute's purpose.

The court then considered the statute's second purpose: "fostering 'vigorous and healthy competition' in the motor vehicle industry." If Central were to win, it would "guarantee franchisees protection from any downturn in the market while denying franchisors the ability to react to that same market by compelling them to pay a substantial penalty to dealers for discontinuing any unprofitable product line." The court was unwilling to infer that the Maryland legislature intended to make owning a franchise risk-free. The court reasoned that competition is improved, and the public, including the franchisee, is benefitted when franchisors are allowed to respond to changing market conditions by reinvesting assets. Thus, requiring GMC to pay damages for terminating an unprofitable product line would not further the Maryland statute's purpose.

107.  Id. at 333.
108.  For example, Volvo owned 76% of the joint venture's stock and controlled seven of the ten seats on the board of directors. Volvo controlled the daily operations of the joint venture, and the joint venture had its own management team and manufacturing facilities. Id.
109.  The court noted that by 1985 GMC had become "the smallest of the seven major [heavy duty truck] industry competitors within the United States" and its market share had declined by almost half in four years. Id. at 329.
110.  Id. at 333.
111.  Id. (citation omitted).
112.  Id. at 333-34.
113.  Id. at 334.
114.  Id.
5. New Jersey, Round 2: Gallo's rationale rejected, but questions remain

Three years following Gallo,115 a second federal district court in New Jersey was presented with the same issue in Freedman Truck Center v. General Motors Corp.116 However, this court rejected Gallo's holding that every general market withdrawal violates the NJFPA.117 The court began by noting that the NJFPA's legislative history documented witnesses' testimony about "'capricious action by franchisors . . . [who] refus[ed] to renew one successful franchise in order to give that business opportunity to a more favored entrepreneur.'"118 From these statements the court concluded that the legislature apparently had not addressed general market withdrawal by the franchisor.119

Next, the court considered the principal case relied on by Gallo, Westfield Centre Service v. Cities Service Oil Co., which held that the NJFPA was violated unless the franchisee substantially breached its obligations.120 In Westfield, the New Jersey Supreme Court found that Cities Service violated the NJFPA when, as part of its evaluation of its New Jersey holdings, it terminated Westfield's franchise because a gas station was no longer economically feasible at that location.121 The Freedman court distinguished Westfield on the basis that the franchisor in Westfield had not completely withdrawn from the market and the franchisor had served its own interests at the expense of its franchisee because of its stronger bargaining position.122 In contrast, a total market withdrawal would not present an opportunity for such abuses. The franchisor "cannot appropriate the goodwill of a terminated dealer by diverting its business to favored franchisees," nor is there any possibility of "the franchisor driving an unconscionably hard bargain" because there is no bargain to be made.123 This reasoning led

117. Id. at 173.
118. Id. at 170 (citation omitted).
119. Id.
121. Id. at 51-52.
123. Id. at 172.
the *Freedman* court to reject *Gallo*'s holding that market withdrawal violates the NJFPA per se.

However, because of the way in which GMC exited the New Jersey market, the court did not grant GMC's motion to dismiss on the good cause issue. First, GMC continued production of the Brigadier for one year following its termination of Freedman's franchise, and it offered the truck to some former franchisees. Presuming the heavy duty truck was a franchise, the court found the facts presented a triable issue on whether GMC had discriminatorily terminated Freedman's franchise without the defense of market withdrawal.\(^{124}\)

Second, despite its departure from manufacturing heavy duty trucks, GMC still preserved a market presence through the survival of its tradename and through the former GMC dealers who were offered new franchises by the joint venture. The court reasoned:

> To the extent that the chosen franchisees sold substantially the same products to substantially the same markets with which GM franchisees had formerly done business, and thereby derived a benefit from goodwill already associated with the GM name, they would be free-riding on the efforts of all former GM franchisees . . . . Such an uncompensated appropriation of the labor and capital of terminated franchisees would be made possible by the superior bargaining position of the franchisor.\(^{125}\)

If this had occurred, the court believed that GMC would have violated the good cause provisions under the NJFPA.

### D. Reconciling the Irreconcilable: The GMC Opinions

In essence, the dealers in the above cases were successful when the courts focused on GMC's continued production of the Brigadier. The courts in Wisconsin, Maine, New York, and New Jersey\(^{126}\) all found triable factual issues on whether GMC in fact withdrew from the heavy duty truck market while still manufacturing the Brigadier for the joint venture. Maine, New York, and New Jersey\(^{127}\) also considered GMC's withdrawal

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124. *Id.* at 173.
125. *Id.* at 173-74.
126. See discussion *supra* parts III.B.1, III.B.2, III.B.3, III.C.5.
127. See discussion *supra* parts III.B.2, III.B.3, III.C.5.
to present triable issues because GMC had some control over the joint venture and because GMC's trademark remained visible by its incorporation in the joint venture's name.

Rather than focusing on GMC's continued market presence, the courts in which GMC or Volvo White received favorable rulings focused on GMC's motives for forming the joint venture. The Massachusetts, Pennsylvania, and North Carolina\(^ {128} \) courts did not mention the Brigadier in their analysis but discussed GMC's need to reverse its declining market share. The only court in which GMC won that acknowledged the issues involving the Brigadier and GMC's control over the joint venture was the Fourth Circuit, interpreting Maryland law.\(^ {129} \) The Fourth Circuit emphasized GMC's formation of the joint venture as a lawful response to unfavorable market conditions and chose to leave unresolved the issues of the Brigadier and continued market participation through the joint venture. With regard to GMC's poor financial prospects and its limited choices, the Fourth Circuit's reasoning was similar to that of the Pennsylvania and North Carolina courts. The Massachusetts decision is an anomaly because the court focused on Volvo GM's selection of dealers for the new joint venture rather than its continued production of Volvo White models or its reasons for forming the joint venture.

To some extent, the court's focus is dictated by the statutory definitions of good cause.\(^ {130} \) The Massachusetts and Pennsylvania statutes encourage a judicial inquiry into the manufacturer's motives; Massachusetts directs the court to consider "all pertinent circumstances," and Pennsylvania exempts terminations made in "good faith."\(^ {131} \) Given the mandate to consider motive, the result in favor of GMC is not surprising. In contrast, the Wisconsin and New Jersey statutes define good cause according to the dealer's circumstances; Wisconsin considers termination in light of the equities of the dealer, and New Jersey limits good cause to substantial breaches by the dealer.\(^ {132} \) Since both statutes disregard the manufacturer's circumstances, the findings in favor of the deal-

\(^ {128} \) See discussion supra parts III.C.1, III.C.2, III.C.3.
\(^ {129} \) See discussion supra part III.C.4.
\(^ {130} \) The following discussion omits any reference to the Maine or New York statutes because the cases were decided on summary judgment without any interpretation of the good cause standard.
\(^ {131} \) See supra notes 81 and 88.
\(^ {132} \) See supra notes 55 and 75.
ers by the Wisconsin court and the New Jersey court in *Gallo* are not unexpected.

What is unexpected, perhaps, is GMC's success in Maryland and North Carolina given that their statutes\(^{133}\) are substantively identical to New Jersey's. The North Carolina and Maryland courts, as well as the New Jersey court in *Freedman*, looked beyond the statutory language to the economic realities of GMC's situation\(^{134}\) and the policies underlying the statutes. New Jersey and Maryland enacted legislation to prevent the manufacturer from abusing its stronger bargaining position and from appropriating its dealers' good will.\(^{135}\) Economic restructuring by complete market withdrawal did not present a situation in which the manufacturer could abuse its position or appropriate its dealers' good will because no dealer would exist to whom it could divert business.

However, despite similar statutory policies, the Maryland and New Jersey courts reached contrary results because each court characterized GMC's actions differently. The Maryland court found that GMC did withdraw from the market because it canceled all of its heavy duty truck addenda.\(^{136}\) Furthermore, GMC's participation in the joint venture was not an issue because it was a legitimate response to changing market conditions. In contrast, the New Jersey court in *Freedman* considered GMC's actions after its cancellation of the heavy duty truck addenda. The court found that GMC's market withdrawal may not have been complete since the joint venture dealers, chosen from former GMC and Volvo White dealers, were selling substantially the same products to the same market.\(^{137}\) In this situation, the new dealers could free ride on the efforts of the terminated dealer to establish a local market for GMC's heavy duty trucks. In effect, GMC may have appropriated its former dealer's good will because of its bargaining power, an action contrary to the statute's purpose.

\(^{133}\) *See supra* notes 96 and 104.

\(^{134}\) At the time GMC announced its participation in the joint venture, the heavy duty truck market was changing due to "decreases in demand, deregulation of the trucking industry, increased international competition, and excess manufacturing capacity." *Central GMC, Inc. v. General Motors Corp.*, 946 F.2d 327, 334 (4th Cir. 1991). In response to these conditions, GMC could have liquidated its heavy duty truck division or invested its assets in the joint venture. *Id.* at 333.

\(^{135}\) *See supra* text accompanying notes 106-14 and 115-23.

\(^{136}\) *Central GMC*, 946 F.2d at 333.

\(^{137}\) *See supra* text accompanying notes 124-25.
The protection afforded by franchise relationship statutes is heavily dependent on the good cause definition, as shown by Hacienda and Original Great American Chocolate Chip Cookie. These cases also demonstrate how the good cause definition limits protection to only the franchisee's interests, given the underlying public policy of equalizing the parties' bargaining positions.

This approach, however, overlooks the mutual benefit and dependency inherent in the franchise relationship. The franchisor has invested time, energy, and capital into establishing a reliable reputation for her product or service among the public; the franchisee has invested time, energy, and capital into building a business. Both parties enter the relationship expecting to achieve economic benefits. However, when the economic benefits diminish to the point that the franchisor wishes to withdraw from the market, it finds no equivalent statutory protection. The General Motors case study reveals how the current good cause standards fail to account for the franchisor's need to initiate changes in its marketing activities to respond to changing market conditions and consumer preferences. Thus, given some statutes' lack of protection for the franchisor, state legislatures should redraft the good cause definition to effect a balance between the franchisor's business needs and the franchisee's interest in continuing the franchise.

Rose Marie Reynolds

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