THE IMPACT OF THE UNIFORM COMMERCIAL CODE (“UCC”) ON FRANCHISING

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I. INTRODUCTION AND UCC APPLICABILITY TO FRANCHISES

This program was inspired by the observation of a presenter at last year's Forum on Franchising that “franchise lawyers” would benefit from a program focusing on the Uniform Commercial Code (“UCC”), specifically the “core” principles in Articles 1 General Provisions and 2 Sales. As the authors of these materials we agree, and have learned (or re-learned) a great deal about some important points of law in preparing this paper.

Section One of this paper sets the stage by explaining the historical development of the UCC and, as an issue of threshold importance, when a contract is governed by Articles 1 and/or 2. Section Two focuses on important provisions of Article 1, most notably the Obligation of Good Faith and the role of Usage in Trade, Course of Dealing and Course of Performance in contract interpretation. Section Three addresses important provisions in Article 2 concerning the enforceability, readjustment, and construction of contracts, including open price terms and warranties. Section Four discusses how the provisions of Article 2 affect whether actions or omissions constitute a breach, whether a party has waived a breach by its conduct, and a party’s remedies in the event of an actionable breach.

Given the scope of Articles One and Two, we could not address the other articles of the UCC, several of which may have substantial relevance in representing franchisors and franchisees, including:

- Article 2A (leases of goods)
- Article 3 (negotiable instruments)
- Article 4A (electronic funds transfers)
- Article 6 (bulk transfers – sales of business assets)
- Article 8 (investment securities)
- Article 9 (secured transactions)

Nevertheless, this paper covers issues of importance to all attorneys who represent franchisors or franchisees. It is particularly relevant to attorneys representing parties whose relationships concern the resale of the franchisor’s proprietary finished goods, such as motor vehicles, heavy equipment and gasoline. However, many portions are applicable to business format franchisors who supply (directly or through an affiliate) ingredients incorporated by franchisees in products sold to consumers, or branded items sold by franchisees to customers. Even if the franchise (or the relevant aspect of it) does not concern transactions in goods, the general provisions of Article 1 (and cases applying them) can be used effectively in disputes between franchisors and franchisees, occasionally as binding authority, and in most cases as persuasive authority. Finally, our focus on Article 2 is intended to enhance the reader’s understanding of commercial principles applicable to the contracts at the heart of all franchise relationships.

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A. **What is the Uniform Commercial Code?**

1. **Historical Background**

   The UCC is a model act promulgated by the National Conference of Commissioners on Uniform State Laws ("NCCUSL") and the American Law Institute ("ALI"). It "purports to deal with all phases which may ordinarily arise in the handling of a commercial transaction, from start to finish."\(^2\)

   The UCC has been called "the most spectacular success story in the history of American law."\(^3\) Since 1978, it has, in some form, served as the basis of the law governing commercial transactions in all fifty states and the District of Columbia.

   The NCCUSL is a nonprofit, unincorporated association that has worked since 1892 to promote uniformity among state laws.\(^4\) It is comprised of state commissions on uniform laws from every state, the District of Columbia, the Commonwealth of Puerto Rico, and the U.S. Virgin Islands.\(^5\) The NCCUSL has drafted more than 200 uniform acts on a wide array of areas of law; yet, it considers the UCC to be its most significant contribution to the practice and study of law.\(^6\)

   The ALI was founded in 1923 with the mission "to promote the clarification and simplification of the law and its better adaptation to social needs," and since its inception has worked to modernize, clarify and restate the American law.\(^7\) The ALI is constituted of a representative gathering of judges, practicing lawyers, and law professors of the American Bar.\(^8\)

   Before creation of the UCC, the NCCUSL had promulgated various separate uniform commercial laws, the most notable being the Uniform Sales Act of 1906. The Uniform Sales Act became outdated by the 1930s, however, because "[c]hanges had occurred in the patterns of commercial activity prevalent when [the Act was] promulgated."\(^9\) The objective of the Uniform Sales Act was uniformity, but only about two-thirds of the states enacted it, and state court "judicial amendments"\(^10\) further thwarted the NCCUSL's objective.

   Instead of revising its various uniform commercial statutes, the NCCUSL sought co-sponsorship with the ALI for the creation of a comprehensive commercial code. The ALI agreed to co-sponsor the UCC in 1944.\(^11\)


\(^3\) 1 JAMES J. WHITE & ROBERT J. SUMMERS, UNIFORM COMMERCIAL CODE 5 (3d ed. 1988).


\(^5\) Id.

\(^6\) Id.


\(^8\) Id.

\(^9\) WHITE & SUMMERS, supra note 3, at 3.

\(^10\) Id.

\(^11\) Id.
The first complete draft of the UCC was finished in 1950 and then circulated widely for comment. The “1952 Official Text” was promulgated in 1951. Article 2 -- the “Sales Article” -- governs “transactions in goods” and replaced the Uniform Sales Act.

While the 1952 Official Text was widely praised, it did receive substantial critical comment. The 1957 Official Text was issued in response to that criticism, including changes “recommended” by the New York Legislature. Subsequent Official Texts in 1958 and 1962 made only relatively minor changes to the 1957 version. Later versions have altered the substance of the UCC in response to both criticism and changes in the common law; however, the original objectives and purposes of the UCC have remained solidly in tact, and continue to drive its evolution going forward.

2. Recent Revisions to the Uniform Commercial Code

Beginning in 1987, the majority of the UCC underwent extensive revision. Particularly relevant here are the revision of Article 1 issued in 2001, including the deletion of section 1-206, and the large-scale revision of Article 2 issued in 2003. We hereafter refer to the sections of UCC Articles 1 and 2 as reissued during this decade as “Revised Section ____” and the sections before those revisions as “Original Section ____.”

3. State Adoption of the Uniform Commercial Code

As stated above, some form of the UCC is in effect in every state and the District of Columbia. However, many states have adopted Articles 1 and 2 only in part or have adopted non-uniform amendments. It is especially noteworthy that, to date, the 2003 revision of Article 2, has only been adopted by Oklahoma, and even there only in part. For these reasons, it is important for attorneys to know which version of Articles 1 and 2 are in effect in their jurisdiction, in addition to having a firm grasp of both the scope of the UCC’s application and its effect on the contents of their client’s contracts.

4. Objective and Purposes of the Uniform Commercial Code

The principal objective behind the promulgation of the UCC was the advancement of “[u]niformity throughout American jurisdictions.” Courts continue to recognize and be influenced in their decisions by this fundamental principle of the UCC.

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14 The most recent version is the “2005 Official Text.”
15 WHITE & SUMMERS, supra note 3, at 4.
16 Before the 2004 revision, section 1-206 provided a statute of frauds for sales contracts not otherwise governed by Article 2. As explained below, this section has particular relevance to franchise law where it is still in force. Equally noteworthy, however, is the recognition in the Legislative Note to the 2004 version of section 1-206 that a uniform body of law is no longer required to govern the issue. This implies that other sources of law must be consulted when confronted with a statute of frauds issue in a sales contract not governed by Article 2.
17 See supra Section I.A.
19 U.C.C. general cmt.
Before the promulgation of the 1962 Official Text, the NCCUSL and the ALI established the Permanent Editorial Board, which still exists, to conduct and oversee the drafting and revision of the UCC. The Permanent Editorial Board was instituted to accomplish the tasks of “promoting uniformity in the state by state enactment and interpretation of the code,” and “evaluating and preparing proposals for revision of the . . . Official Text.”21

These tasks mirror the purposes of the UCC as stated in Revised Section 1-103(a). The “underlying purposes and policies of the Act are:

1. to simplify, clarify and modernize the law governing commercial transactions;
2. to permit the continued expansion of commercial practices through custom, usage and agreement of the parties;
3. to make uniform the law among the various jurisdictions.”22

The Official Comments to the UCC are intended to facilitate the states’ adherence to these underlying purposes and policies. The Official Comments explain the UCC’s statutory text and operation and the drafters’ intent behind its provisions. They have not been adopted in all states; but where they have, they serve as persuasive authority on the application and interrelation of the Articles and their provisions.

5. **The Uniform Commercial Code Is to Be Liberally Construed.**

The UCC is intended to be fully consistent with freedom of contract.23 Most of the provisions in the UCC are not mandatory, and thus may be modified or avoided by the parties if they so intend.

The UCC “shall be liberally construed and applied to promote its underlying purposes and policies.”24 The influence of this language in Article 1 is unclear because courts tend to rely on other liberalizing provisions found within the substantive Articles.25 Nonetheless, the liberal construction rule of Article 1 has been applied independently. For example, in *All-States Leasing*...
Co. v. Bass, the Idaho Supreme Court relied on Idaho’s version of section 1-102 when it extended the implied warranty provisions of Article 2 to apply to a business-to-business lease contract.

The UCC is not intended to be the exclusive source of authority for the law governing commercial transactions. As stated in Revised Section 1-103(b), “unless displaced by the particular provisions of this Act, the principles of law and equity . . . supplement its provisions.” Thus, the common law doctrine of contracts remains in force even in states that have adopted the UCC, except as specifically displaced by its provisions. Practicing attorneys must not overlook the limited scope and deferential nature of the UCC, and thereby ignore relevant and authoritative statutory and common law.

B. When Is a Contract Involving a Provision for Sale Governed by the Uniform Commercial Code?

Contracts involving “transactions in goods” are governed by Article 2 of the UCC. Unfortunately, application of the Sales Article is not clear cut. Of principal importance in this respect are “mixed” contracts, involving both the sale of goods and the provision of services.

It is also essential for practicing lawyers to understand the relationship of Article 1 to the rest of the UCC.

1. The Scope of Article 1

Article 1 provides general rules and definitions which apply to matters covered under the ten substantive articles of the UCC. It “applies to a transaction to the extent that it is governed by another article of [the UCC].” For example, sections 1-103(a) and 1-104 provide rules of construction for the application of the substantive articles and section 1-201 provides definitions for terms used in the substantive articles.

It should be noted, however, that Original Section 1-206 has been applied to transactions not governed by any other article of the UCC. Original Section 1-206 is a statute of frauds

27 Id. at 1182; see also Minsel v. El Rancho Mobile Home Ctr., Inc., 188 N.W.2d 9 (Mich. Ct. App. 1971) (upholding the enforceability of a purchase contract based upon the liberal construction of Article 2 under Michigan’s version of 1-102). It should be noted that business-to-business lease contracts are now governed by UCC Article 2A, entitled “Leases,” in states where that article has been enacted.
28 See WHITE & SUMMERS, supra note 3, at 6-7 (stating that the UCC “derives from the common law [and] assumes the continuing existence of a large body of pre-Code and non-Code law on which it rests for support (quoting Grant Gilmore, Article 9: What It Does For the Past, 26 LA. L. REV. 285, 285-86 (1966))).
29 § 1-103(b).
30 Section 1-103 provides a non-exclusive list of areas of commercial law, including agency, estoppel and fraud, which continue to be governed by the common law even in jurisdictions where the UCC has been enacted. Id.
31 § 2-102.
32 See infra Part II.B.1, 3.
33 See § 1-102.
34 Id.
35 References to “Former” sections of article 1 refer to the version of the UCC in effect before the revisions of Article 1 issued in 2003.
provision barring the enforcement of oral agreements for the sale of “personal property” other than goods, securities and security agreements in exchange for five thousand dollars or more in value.\textsuperscript{36} Thus, this provision is intended to cover “general intangibles” constituting personal property.

A franchise agreement is a general intangible that falls within the scope of Original Section 1-206. In \textit{Ackerman Buick, Inc. v. General Motors Corp.},\textsuperscript{37} the court refused to enforce an oral contract for the sale of a franchise under the Missouri analog to Original Section 1-206.\textsuperscript{38} The court held that a franchise agreement itself is \textit{intangible personal property}, in that it “has no intrinsic and marketable value, but is merely the representative of evidence or value.”\textsuperscript{39} Accordingly, the parties’ alleged oral agreement to grant the plaintiff an additional automobile dealership concerned an intangible personal property right governed by Original Section 1-206, and since that right was worth substantially more than five thousand dollars the alleged agreement was unenforceable as a matter of law.\textsuperscript{40}

Thus, where it remains in force, Original Section 1-206 applies irrespective of whether the predominant purpose of the agreement is goods or services.\textsuperscript{41} As seen above, this provision can be a potent weapon against claims by a franchisee that it had an oral agreement to purchase additional franchise rights beyond the territory or product line franchise previously sold to it.

2. \textbf{The Scope of Article 2}

\textbf{a. Article 2 Applies to “Transactions in Goods”}

Section 2-102 provides that Article 2:

applies to transactions in goods; it does not apply to any transactions which although in the form of an unconditional sales contract to sell or present sale is intended to operate only as a security transaction nor

\begin{itemize}
  \item \textsuperscript{36} Original Section 1-206 provides:
    \begin{itemize}
      \item (1) Except in the cases described in subsection (2) of this section a contract for the sale of personal property is not enforceable by way of action or defense beyond five thousand dollars in amount or value of remedy unless there is something in writing which indicates that a contract for sale has been made between the parties at a defined or stated price, reasonably identifies the subject matter, and is signed by the party against whom enforcement is sought or by his authorized agent.
      \item (2) Subsection (1) of this section does not apply to contracts for the sale of goods [Article 2] nor securities [Article 8] nor to security agreements [Article 9].
    \end{itemize}
  
  
  \textsuperscript{37} 66 S.W.3d 51 (Mo. Ct. App. 2001).
  
  \textsuperscript{38} \textit{Id.} at 60.
  
  \textsuperscript{39} \textit{Id.} at 61 (quoting Norris v. Norris, 731 S.W.2d 844, 845 (Mo. 1987).
  
  \textsuperscript{40} \textit{Id.}
  
  \textsuperscript{41} See \textit{infra} Part II.B.2 for a discussion of the “predominant purpose” test.
\end{itemize}
does this Article impair or repeal any statute regulating sales to consumers, farmers or other specified classes of buyers."42

i. Exclusions

Article 2 does not apply to security transactions.43 It also does not purport to amend or repeal any statutes regulating commercial transactions, and thus does not apply to issues regulated by other commercial statutes.44 This means that the enactment of the UCC does not affect the applicability of “Little FTC Acts,” franchise and business opportunity disclosure acts or substantive franchise relationship statutes.

ii. Definition of Goods

Original Section 2-105, which, to date, is enacted in every state but Oklahoma, defines “goods” as:

all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities (Article 8) and things in action. ‘Goods’ also includes the unborn young of animals and growing crops and other identified things attached to reality . . . .”45

This definition serves as the heart of the Article 2 analysis.

The revisions to Article 2 issued in 2003 altered the definition of goods to provide specifically that “information” is not a good within the scope of Article 2.46 The UCC leaves this term undefined, but the Official Comment to section 2-103 suggests that, at a minimum, “information” includes computer programs. Architectural plans, also are considered “information.” “General intangibles,” such as intellectual property rights, are also not classified as goods under Revised Article 2. However, “smart goods,” such as automobiles and appliances that incorporate computer programs, are considered goods under the Revised Article 2 definition.47


Article 2 covers more than “simply ‘sales’ of goods” contracts.48 Mixed contracts involving both goods and services may also be governed by the UCC where the predominant purpose of the

42 § 2-102.
43 Id.
44 Id.
46 § 2-103(1)(k) (2003); see also Amendments to UCC Article 2, prefatory note (2003).
47 § 2-103 cmt. 7.
48 See, e.g., Sagent Tech., Inc. v. Micros Sys., Inc., 276 F. Supp. 2d 464, 467 (D. Md. 2003) (holding that a computer software distributor license, which “for all practical purposes” was a sales contract, was governed by the UCC because the software was delivered to the licensee in the form of a CD-ROM). It should be noted that this ruling may have been different had Revised Section 2-103(1)(k) been in effect, since its revision of the definition of “goods” was specifically designed to exclude computer programs from the scope of Article 2. See infra Part II.B.1.b.
contract is the sale of goods.49 As explained below, the mixed contract issue is of high import to franchise lawyers, as franchise agreements often involve the sale of inventory or merchandise to the franchisee, as well as provisions for service such as operations, advertising assistance, and licenses of trademarks, service marks and trade secrets.

b. The Predominant Purpose Test for Determining Whether Article 2 Applies to Mixed Contracts

In deciding whether to apply the UCC to a mixed contract, the majority of courts employ the “predominant purpose” test.50 Jurisdictions apply varying definitions of the predominant purpose test,51 but it can generally be stated as follows:

Where a contract mixes the sale of goods with the rendition of services, the contract is covered by the UCC’s provisions for sales of goods only if it is predominantly for goods with service being incidental . . . and not predominantly for service, with goods being incidental. . . .52

Where the predominant purpose test places a contract within Article 2, the majority rule is that the entire contract, including its service provisions, is governed by the UCC to the extent that it applies.53 Where the UCC is silent, the contract will still be governed by non-UCC law. A minority of jurisdictions only apply the UCC to the “sale of goods” aspects of the parties’ dispute.54

49 See infra Part II.B.3.
51 See, e.g., Novamedix, Ltd. v. NDM Acquisition Corp., 166 F.3d 1177, 1182 (Fed. Cir. 1999) (“[I]f the predominant purpose of the transaction is a sale of goods, then the U.C.C. applies to the entire contract.”); AKA Distrib. Co. v. Whirlpool Corp., 137 F.3d 1083, 1085 (8th Cir. 1998) (“The test [for mixed contracts is] whether their predominant factor, their thrust, their purpose, reasonably stated, is the rendition of service, with goods incidentally involved (e.g., contract with artist for painting) or is a transaction of sale, with labor incidentally involved (e.g., installation of a water heater in a bathroom”); (citing Bonebrake v. Cox, 499 F.2d 951, 960 (8th Cir. 1974)); DeFilippo v. Ford Motor Co., 516 F.2d 1313 (3d Cir. 1975) (applying the “dominant factor” test of whether the essence or dominant factor in the formation of the contract is the provision of goods or services); SMR Techs., Bus. Franchise Guide (CCH) ¶ 12,122 (analyzing the “thrust of the agreement” (citing Wang Labs., Inc. v. Lee, Nos. 85C-OC-124, 88C-MY-283, 1989 Del. Super. LEXIS 173 (Del. Super. Ct. Apr. 19, 1989))); Ratterman v. Quality Dining, Inc., Bus. Franchise Guide (CCH) ¶ 11,809 (N.D. Ind. Feb. 22, 2000) (applying the “predominant thrust” test of whether the goods comprise the transaction’s predominant factor in light of the parties’ circumstances, their reasons for contracting, and the relative costs of the goods and services (citing Insul-Mark Midwest, Inc. v. Modern Materials, Inc., 612 N.E.2d 550, 553-55 (Ind. 1993))); Belleville Toyota, Inc. v. Toyota Motor Sales, U.S.A., Inc., 770 N.E.2d 177, 194-95 (Ill. 2002) (“[I]f the contract is predominantly for the sale of goods, with services being incidental thereto, the contract will be governed by article 2. Conversely, if the contract is predominantly for services, with the sale of goods being incidental thereto, the contract will not fall within article 2”).
53 See Respect, Inc. v. Comm. on the Status of Women, 781 F. Supp. 1358, 1364 (N.D. Ill. 1992) (“If the contract is predominantly for goods, then the entire contract falls within the ambit of UCC Article 2.” (citing Zayre Corp. v. S.M. & R. Co., 882 F.2d 1145, 1153 (7th Cir. 1989))).
54 Foster v. Colo. Radio Corp., 381 F.2d 222 (10th Cir. 1967).
Franchise agreements, unlike distributorship agreements, come in a variety of forms. Hence the applicability of the UCC to franchise agreements can best be viewed as a sliding scale, whereas distributorship agreements tend to be governed by the UCC in a fairly uniform manner.

i. **The Easy Cases**

On one end of the scale are those franchise agreements under which the franchisee purchases inventory from the franchisor, and then resells the franchisor’s product on the market. This form of franchise closely mirrors the typical distributorship agreement, and courts have treated them similarly. For example, *Babst v. FMC Corp.*, involved a franchise agreement, the principal purpose of which was for the franchisee to act as a distributor of the franchisor’s automotive service equipment. The court held that such “franchise/distributorship agreements . . . fall squarely under Article 2.”

On the other end of the spectrum are those franchise agreements which provide only for the franchisee’s use or license of the franchisor’s trademarks and “trade secrets” or business methods, including food recipes or specifications. The franchisee in *JRT, Inc. v. TCBY Sys., Inc.*, purchased a license to use such assets and benefit from the goodwill of the TCBY trademark. The franchise agreement also stated that TCBY would provide training and assistance for the operation of the franchise. However, the franchisor did not sell any goods to the franchisee during the franchise relationship. Rather, it provided a list of approved suppliers from whom the franchisee could purchase goods meeting the franchisor’s specifications. The Eighth Circuit held that the franchise agreement was not governed by Article 2.

The same result was recently reached in *Am. Casual Dining v. Moe’s Southwest Grill, LLC*, which concerned a quick service restaurant franchise in which the franchisee was required to purchase ingredients, furnishings and supplies meeting the franchisor’s specifications, in some cases from suppliers designated by the franchisor, but never directly from the franchisor or its affiliates. Moreover, according to the record the franchisor received no income as a result of the

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55 The majority rule is that distributorship agreements satisfy the predominant purpose test and are governed by the UCC. In a mixed contract for sale of distribution rights and sale of goods, the sale of goods to the distributor is considered to be the predominant purpose of the contract. See Ryan v. Wersi Elecs. GmbH & Co., 3 F.3d 174, 181 n.3 (7th Cir. 1993) (sale of twenty percent of distributor’s stock to distributee was the predominant purpose of the distributorship agreement); see also Sally Beauty Co., Inc. v. Nexusx Prods. Co., Inc., 801 F.2d 1001, 1005-06 (7th Cir. 1986) (declaring that where the purpose of the service is to generate sales, the sale of goods is the contract’s predominant purpose); WICO Corp. v. Willis Ind., 567 F. Supp. 352, 355 (N.D. Ill. 1983) (“All the service aspects of the [distributor agreement] are aimed at developing and increasing the market for [the products that are sold by the distributor to the distributee]. This simply is not a situation in which the sale of goods is really incidental to the rendition of services.”).

56 661 F. Supp. 82 (S.D. Miss 1986).

57 *Id.* at 87.


59 Trademark and trade secret licenses, like franchise agreements themselves, are “general intangibles,” personal property which does not qualify as a good under Article 2. The 2003 revision of Article 2 further supports the proposition that transactions in intellectual property are outside of the scope of the Sales Article by indicating that “information” is not a good. Ackerman Buick, Inc. v. General Motors Corp., 66 S.W.3d 51, 60 (Mo. Ct. App. 2001).

60 *JRT, Inc.*, Bus. Franchise Guide (CCH) ¶ 10,571.

franchisee’s purchases. Accordingly, the court found that the predominant purpose of the contract was not the sale of goods and thus, that it was not governed by Article 2.62

These are the easy cases. The question of the predominant purpose of a franchise agreement becomes more complex where the agreement involves both a sale of goods to the franchisee and provisions for services.

ii. Cases Finding Sales to Be the Predominant Purpose of a Franchise Agreement

Sale of goods and service provisions in “mixed” franchise agreements can exist in any relative proportion. Hence, the application of the predominant purpose test becomes essential in determining whether a franchise agreement is governed by Article 2. Noteworthy in this respect is the court’s statement in Ross-Simons of Warwick, Inc. v. Baccarat, Inc., 63 that the title of the agreement, though “not necessarily determinative of the agreement’s predominant purpose . . . can constitute potent evidence of that purpose.”64 Thus, in applying the predominant purpose test, courts may consider the title of the franchise agreement in weighing the relative import of its sales, service and intellectual property rights provisions.

In Korangy v. Mobil Oil Corp.,65 Mobil entered into a franchise agreement for Korangy to operate a distributorship/franchise Mobil service station. Mobil also leased the premises for the station to the franchisee. The Court held that the franchise agreement was governed by the UCC, even though the lease was essential to the franchise arrangement, because the predominant purpose of the agreement was “to govern the sale of Mobil’s oil products.”66 This decision is consistent with most cases involving gasoline service station franchises and makes intuitive sense. While oil refiners profit from leasing or sub-leasing the gas station premises to dealers, the predominant purposes of such dealer relationships is as a method of distributing the refiners’ gasoline products for resale to the driving public.

Old Country Toyota Corp. v. Toyota Motor Distrib., Inc.,67 involved a franchise agreement for the operation of an automobile dealership. A “Unit Allocation” provision established specifications for Toyota’s supplying of vehicles to the franchisee. The agreement also included service provisions for premises maintenance, accounting methods, maintenance of net working capital and display of Toyota’s trademarks. The court found the “Unit Allocation” provision to be the predominant purpose of the contract. The court stated that the service provisions were “collateral to [the agreement’s] primary purpose of facilitating sales” of motor vehicles between the franchisor and franchisee, and that the maintenance and accounting provisions were “housekeeping matters with little bearing on the [c]ourt’s analysis.”68 The purpose of the service provisions was to facilitate

62 Id. at 1370.
63 102 F.3d 12 (1st Cir. 1996).
64 Id. at 18. There an “Agreement of Compromise and Settlement” between manufacturer and distributor was held to be a contract for services not governed by Article 2, despite the fact that the underlying relationship between the parties involved sales of goods. Id.
66 Id. at 667.
68 Id. at 171.
the franchisee’s sales of Toyota vehicles to the public, and they thus were not the predominant purpose of the agreement. 69

iii. Cases Finding Sales Not to Be the Predominant Purpose of a Franchise Agreement

At some point along the sliding scale of proportionality between sales of goods provisions and service provisions the outcome has to change. Where a sales provision is “but one of many documents in the overall contractual package,” it may lose its status as the predominant purpose of the contract. 70

In Zapatha v. Dairy Mart, Inc.,71 the court found that the sale of goods was not the predominant purpose of the subject franchise agreement. Zapatha involved a franchise agreement which provided that the franchisee would operate a Dairy Mart convenience store using the Dairy Mart trademark and merchandizing methods. Dairy Mart agreed to furnish the store with any necessary equipment, pay the franchisee’s rent and utility bills and cover the franchisee’s other costs of doing business. The franchisee purchased approximately thirty percent of its inventory from Dairy Mart, and Dairy Mart was to receive a franchise fee computed as a percentage of the franchisee’s gross revenue. In finding that the predominant purpose of the franchise agreement was not the sale of goods, the court noted that the franchisee purchased only a small portion of its inventory from the franchisor and that “Dairy Mart’s profit was intended to come from the franchise fee and not from the sale of items to its franchisees.” 72 The court held that the sale of goods “was, in a commercial sense, a minor aspect of the entire [franchise] relationship,” and specifically noted that the relationship was a “business format” franchise primarily involving the license of trademarks and business system in exchange for royalties. 73

Additionally, in Au Rustproofing Ctr., the parties entered a franchise agreement for the franchisee to sell Gulf petroleum products. Under the agreement, the franchisee would buy gasoline from Gulf at a discounted price and then resell it at its present and prospective carwash centers. The agreement also provided that Gulf would loan money to the franchisee for structural improvements and construction at the carwash centers, subsidize the franchisee’s retailing and advertising costs and provide marketing equipment.74 The U.S. Court of Appeals for the Sixth Circuit held that the agreement was not governed by the UCC. The primary purpose of the franchise agreement was the establishment of the franchise dealership; the provision for the sale of gasoline, while clearly central, “[did] not warrant finding the entire agreement as one predominantly for sale of goods.” 75 The more specific issue before the Court was whether the Article 2 statute of limitations barred the franchisee’s claims for advertising and marketing allowance funds. In ruling that it did not, the court further noted the fact that the claims at issue did not concern the sale of goods.

69 Id.
70 Au Rustproofing Ctr., Inc. v. Gulf Oil Corp., 755 F.2d 1231, 1238 (6th Cir. 1985).
71 408 N.E.2d 1370 (Mass. 1980).
72 Id. at 1375.
73 Id.
74 Au Rustproofing Ctr., 755 F.2d at 1233.
75 Id. at 1238.
c. **What Does All of This Mean for Franchise Attorneys?**

Attorneys seeking to determine whether Article 2 governs a franchise agreement should keep the following principles in mind. If the franchise at issue is a distributorship or dealership in which the franchisee purchases its entire inventory from the franchisor, it will likely be subject to the UCC.\(^76\) So long as the franchisee purchases its entire stock from the franchisor, even where other service or license provisions are involved, courts are likely to apply the UCC.\(^77\) However, where the sale of goods is only incidental to the purpose of establishing a franchise and does not constitute a substantial profit center for the franchisor, courts are unlikely to find that a franchise agreement is governed by Article 2.\(^78\) Where the franchisee does not purchase any goods from the franchisor or its affiliates, Article 2 should not apply, even if the franchisee must purchase products from specified vendors approved by the franchisor.\(^79\)

However, even if the franchise agreement itself is not governed by Article 2, product warranties provided by designated suppliers under Article 2 may be relevant to the franchise relationship. For example, a franchisor that refuses to allow its franchisee to use an alternative supplier after the designated supplier provides defective goods may be held liable for breaching the implied covenant of good faith and fair dealing in the franchise agreement.\(^80\)

II. **ARTICLE I: OBLIGATION OF GOOD FAITH AND IMPACT ON FRANCHISE RELATIONSHIP**

There is an obligation of good faith in the performance of every contract to which the UCC applies.\(^81\) Section 1-203 provides that “[e]very contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.” As discussed above, the applicable definition of good faith turns on whether the contract involves the sale of goods and on which version of the UCC – Original or Revised – governs the contract.

There are two versions of UCC Article 1: the original version, and a 2001 revision. As of this writing, 18 states and the Virgin Islands have adopted the revised version of UCC Article 1.\(^82\)

\(^76\) See Babst v. FMC Corp., 661 F. Supp. 82 (S.D. Miss 1986).
\(^77\) See Korangy v. Mobil Oil Corp., 84 F. Supp. 2d 660 (D. Md. 2000). The authors view the decision in *Au Rustproofing Ctr.*, as an anomaly. It concerned a gasoline dealership agreement in which the dealer was not operating primarily under the Gulf Oil trademark and the court appeared to have been heavily influenced by the nature of the parties’ dispute, rather than the actual thrust of their relationship. Based on our research, the vast majority of courts addressing gasoline dealerships have freely applied Article 2, and in fact *Au Rustproofing Ctr.* did so in the same opinion when it cited the Ohio analog to section 2-305(2) concerning open price terms being fixed in good faith. *Au Rustproofing Ctr.*, 755 F.2d at 1235-36.

\(^80\) See, e.g., Ponderosa System, Inc. v. Brandt, 767 F.2d 668 (10th Cir. 1985) (under Wyoming law).
\(^81\) § 1-304; § 1-203 (2001) (prior to 2003 amendment).

Both versions of section 1-201 contain definitions that apply generally throughout all Articles of the UCC. The important definitions for franchise agreements are “good faith,” “agreement,” “contract,” “party,” “person,” and, in revised Article 1, “consumer.”

83 Revised Article I provides in relevant part:

§ 1-201. General Definitions.

(a) Unless the context otherwise requires, words or phrases defined in this section, or in the additional definitions contained in other Articles of [the Uniform Commercial Code] that apply to particular Articles or parts thereof, have the meanings stated.

(b) Subject to definitions contained in other Articles of [the Uniform Commercial Code] that apply to particular Articles or parts thereof:

(3) “Agreement”, as distinguished from “contract”, means the bargain of the parties in fact, as found in their language or inferred from other circumstances, including course of performance, course of dealing, or usage of trade as provided in Section 1-303.

(11) “Consumer” means an individual who enters into a transaction primarily for personal, family, or household purposes.

(12) “Contract”, as distinguished from “agreement”, means the total legal obligation that results from the parties’ agreement as determined by [the Uniform Commercial Code] as supplemented by any other applicable laws.

(20) “Good faith,” except as otherwise provided in Article 5, means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(26) “Party”, as distinguished from “third party”, means a person that has engaged in a transaction or made an agreement subject to [the Uniform Commercial Code].

(27) “Person” means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency, or instrumentality, public corporation, or any other legal or commercial entity.

U.C.C § 1-201 (2001). Original Article 1 provides in relevant part:

§ 1-201. General Definitions.

Subject to additional definitions contained in the subsequent Articles of this Act which are applicable to specific Articles or Parts thereof, and unless the context otherwise requires, in this Act:

(continued...)
The revision of the definition of “good faith” is the most important difference between the two versions of Article 1. In Revised Article 1, the test for “good faith” includes both a subjective component of “honesty in fact” and an objective component, “observance of reasonable commercial standards of fair dealing.” By contrast, in Original Article 1, “good faith” is defined subjectively, by the actor’s “honesty in fact” in performing the requirements of the agreement, while the objective component to the definition – a requirement that parties observe reasonable commercial standards of fair dealing – was only part of Original Article 2.84

There is an obligation of good faith in the performance of every contract to which the UCC applies.85 Section 1-203 provides that “[e]very contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.” As discussed above, the applicable definition of good faith turns on whether the contract involves the sale of goods and on the jurisdiction which governs the contract.

Accordingly, if a contract, such as a franchise agreement, involves the sale of goods or the jurisdiction has adopted Revised section 1-203, good faith is defined as honesty in fact and observance of reasonable commercial standards of fair dealing. However, if it is not a contract for the sale of goods and the jurisdiction has not adopted Revised section 1-203, then good faith is defined as honesty in fact in performing the requirements of the agreement.

(.continued)

(3) “Agreement” means the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in this Act (Sections 1-205, 2-208, and 2A-207). Whether an agreement has legal consequences is determined by the provisions of this Act, if applicable; otherwise by the law of contracts (Section 1-103). (Compare “Contract”.)

(11) “Contract” means the total legal obligation which results from the parties’ agreement as affected by this Act and any other applicable rules of law. (Compare “Agreement”.)

(19) “Good faith” means honesty in fact in the conduct or transaction concerned.

(29) “Party” as distinct from “third party”, means a person who has engaged in a transaction or made an agreement within this Act.

(30) “Person” includes an individual or an organization.

UCC § 1-201 (1998).

84 See § 2-103.

Regardless of the definition, the obligation of good faith generally protects the contracting parties’ reasonable expectations in the franchise agreement. In *Conoco Inc. v. Inman Oil Co., Inc.*[^86^], the court held that, although there was nothing in the contract prohibiting such actions, the solicitation of direct purchasers in competition with a distributor violated the duty of good faith.[^87^] In so holding, the court interpreted the duty of good faith to impose on the contracting parties the duty “to do nothing destructive of the other party’s right to enjoy the fruits of the contract and to do everything that the contract presupposes they will do to accomplish its purpose.”[^88^] For example, in *Bob’s Shell, Inc. v. O’Connell Oil Associates, Inc.*[^89^], the court held that a jury could find that a franchisor breached the duty of good faith if it set gas prices to drive some of its franchisees out of business.[^90^]

Despite its general applicability, courts have been reluctant to impose the obligation of good faith and fair dealing when it directly conflicts with express contract terms. In other words, the obligation of good faith does not authorize an inquiry into the fairness or reasonableness of the explicit contract terms themselves.

In *Corenswet, Inc. v. Amana Refrigeration, Inc.*,[^91^] the court held that the obligation of good faith under the UCC did not bar unilateral arbitrary terminations of distributorship agreements when the contract expressly permitted such terminations.[^92^] There, an exclusive wholesale distributor of home products manufactured by the defendant sued to prevent the manufacturer from terminating the business relationship. The U.S. Court of Appeals for the Fifth Circuit held that the contract explicitly provided that both parties could terminate the contract for any reason and that the obligation of good faith could not be used to override this express term of the contract.[^93^] Other cases have reached similar results.[^94^]

The reluctance to impose the obligation of good faith and fair dealing when it conflicts with express contract terms is so strong that courts have refused to impose it regardless of the motive of the acting party.[^95^] In *Zapatha v. Dairy Mart, Inc.*,[^96^] the franchise agreement included a provision

[^86^]: 774 F.2d 895 (8th Cir. 1985).
[^87^]: Id. at 909.
[^88^]: Id.
[^90^]: Id. at *8.
[^91^]: 594 F.2d 129 (5th Cir. 1979).
[^92^]: Id. at 139.
[^93^]: Id.
[^94^]: See, e.g., Infomax Office Sys., Inc. v. MBO Binder & Co. of Am., 976 F. Supp. 1247 (S.D. Iowa, 1997) (holding that the implied covenant of good faith does not override express termination provisions in a franchise agreement); *In re Sizzler Rest. Int'l, Inc.*, 225 B.R. 466 (Bankr. C.D. Cal. 1998) (finding that the implied covenant of good faith did not nullify express provisions of a franchise licensing agreement); Adolph Coors Co. v. Rodriguez, 780 S.W.2d 477, 482 (Tex. 1989) (refusing to nullify express provisions of a distributorship contract and noting that “the duty of good faith and fair dealing is aimed at making effective [an] agreement’s promises,” not reforming an agreement).

(continued...)
permitting termination of the contract without cause provided 90 days notice was given. The court refused to impose the obligation of good faith in light of the express terms of the contract regardless of the fact that the sole reason for terminating the franchise agreement was the franchisee’s unwillingness to sign a new contract with some less favorable terms. The court found that the franchisor followed the obligations outlined in the contract and therefore dealt honestly with the franchisee.

Some courts have also refused to extend the obligation of good faith to pre-agreement conduct. For example, in Richard Short Oil Co., Inc. v. Texaco, Inc., Texaco introduced a cap on rebate rates to its oil distributor. One distributor claimed that the cap put it at a competitive disadvantage against Texaco’s direct delivery outlets. The court found that Texaco did not breach the UCC duty of good faith because Texaco announced that it was introducing the cap on its rebate program before the parties entered into the second contract and before Short accepted that contract. The distributor did not present evidence of practice in the industry with regard to distributor rebates and there was no showing that Texaco was dishonest with the distributor. In addition, in Bonfield v. AAMCO Transmissions, Inc., the court held that the obligation of good faith did not apply to pre-contractual negotiations.

III. IMPORTANT ISSUES IN ARTICLE II

A. Open Price Terms.

In franchise agreements open price terms are the norm, not the exception, particularly for franchises involving the sale of goods. Because of the on-going and typically long-term relationship between franchisor and franchisee, the price terms for products in franchise agreements are commonly left open and are subject to periodic changes. For example, one major motor vehicle franchise agreement provides:

Prices, destination charges, and other terms of sale applicable to purchases of new Motor Vehicles will be those established according to Vehicle Terms of Sale Bulletins furnished periodically to Dealer.

Prices, destination charges, and other terms of sale applicable to any Motor Vehicle may be changed at any time. Except as otherwise provided in writing or electronically, changes apply to Motor Vehicles not shipped to Dealer at the time the changes are made effective. Dealer will receive written or electronic notice of any price increase before any Motor Vehicle to which such increase applies is shipped, except for initial prices for a new model year or for any new model or

(...continued)

96 408 N.E.2d 1370 (Mass. 1980).
97 Id. at 1378.
98 799 F.2d 415 (8th Cir. 1986).
99 Id.
body type. Dealer has the right to cancel or modify the affected orders by delivering written or electronic notice to [franchisor] within 10 days after its receipt of the price increase notice in accordance with procedures established by [franchisor].

Under this approach, which is quite common in motor vehicle franchise agreements and other sales-of-goods franchises, the franchisor either expressly or impliedly retains the unilateral right to establish and change prices for its products. The question at hand is how the UCC and the franchise relationship affect this right.

The franchisor’s right unilaterally to establish and change the prices for its products is clearly supported by the UCC and relevant case law. However, this is not an unfettered or arbitrary right. Section 2-305 expressly empowers the seller (i.e., franchisor) to do this, as long as the price is fixed in good faith. Section 2-103 defines good faith -- in the case of a merchant -- as honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.

Even beyond this statutory constraint, in franchise cases the courts have routinely established a more demanding covenant of good faith and fair dealing in the open price area.\(^{101}\) This approach necessarily entails a factual examination of the price increases and the franchisor’s motive.\(^{102}\) The simple exercise of its price-setting discretion does not, by itself, constitute a violation nor is the franchisor’s intention to maximize its profit necessarily wrongful.\(^{103}\)

Price increases beyond the reasonable expectation of the parties, and increases supported by improper motives, are likely to be struck down. For example, in Amoco Oil Co. v. Ervin\(^ {104}\) a change in price formula was found to violate the covenant of good faith and fair dealing because the change was considered tantamount to a double charge. This judicial construction is derived from the franchise relationship itself, since franchisees have a diminished bargaining power once they make a firm investment in the franchise.\(^ {105}\) Thus, the courts may need to prevent the franchisor from acting opportunistically.

B. Unconscionability, Waiver and Other Contract Formation and Construction Issues


\(^{102}\) Id. at 1129. In this regard, the New Jersey Supreme Court laid down the rule that the duty of good faith and fair dealing will be breached if:

> [t]hat party exercises its discretionary authority arbitrarily, unreasonably or capriciously, with the objective of preventing the other party from receiving its reasonably expected fruits under the contract. Such risks clearly would be beyond the expectations of the parties at the formation of a contract when parties reasonably intend their business relationship to be mutually beneficial. They do not reasonably intend that one party would use the powers bestowed on it to destroy unilaterally the other’s expectations without legitimate purpose.

Id. at 1130.


\(^{104}\) 908 P.2d 493 (Colo. 1996).

\(^{105}\) Wright-Moore Corp. v. Ricoh Corp., 908 F.2d 128, 135 (7th Cir. 1990).
1. **Modification or Waiver**

Section 2-209 governs modification, rescission and waiver of contract terms. While separate and distinct doctrines, the application of modification and waiver can often overlap in many respects. Thus, it is essential that attorneys facing issues involving modification or waiver of contract terms thoroughly understand the interrelation of Section 2-209’s subsections, as well as their relations to other sections of Article 2.

At its heart, section 2-209 is a recognition of the need for at least some regulation of the admissibility of parol evidence to support contract modifications.

a. **Oral Modification**

Questions about the enforceability of an allegedly modified contract term often center on whether the alleged modification violates a “no oral modification” provision included in the contract. Subsections (2) and (3) of section 2-209 provide a rule for the enforceability of oral modifications that departs greatly from the general common law doctrine. As explained below, the UCC rule in

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106 Section 2-209 provides:

Modification; Rescission and Waiver

(1) An agreement modifying a contract within [Article 2] needs no consideration to be binding.

(2) An agreement in a signed record which excludes modification or rescission except by a signed record may not be otherwise modified or rescinded, but except as between merchants such a requirement in a form supplied by the merchant must be separately signed by the other party.

(3) The requirements of Section 2-201 [Statute of Frauds] must be satisfied if the contract as modified is within its provisions.

(4) Although an attempt at modification or rescission does not satisfy the requirements of subsection (2) or (3), it may operate as a waiver.

(5) A party that has made a waiver affecting an executory portion of a contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver.

§ 2-209.

107 See, e.g., Cloud Corp. v. Hasbro, Inc., 314 F.3d 289, 297 (7th Cir. 2002) (“An attempt at modification that does not satisfy the statute of frauds nevertheless can operate as a waiver.”)

108 The issue of rescission of a franchise agreement has been the subject of several other ABA Forum on Franchising programs and articles, and as rescission is an issue separate and apart from modification and waiver, it is not addressed here.

109 See, e.g., § 2-209 cmt. 3 (“Subsections (2) and (3) are intended to protect against false allegations of oral modifications.”); see also § 2-202 (parol evidence).
section 2-209 provides greater deference than the common law to parties who truly intend to be bound by the terms of their written agreements.\footnote{See § 2-209 cmt. 3 ("Subsection (2) permits the parties in effect to make their own Statute of Frauds as regards any future modification of the contract."). Under the common law, "no oral modification" provisions are essentially unenforceable because they themselves are subject to oral modification. "The 'reasoning' [behind the common law rule is] that the parties were always free to agree orally to cancel their contract and the clause forbidding modifications not in writing would disappear with the rest of the contract when it was cancelled." Wisconsin Knife Works v. Nat'l Metal Crafters, 781 F.2d 1280, 1286 (7th Cir. 1986). The common law rule departs from the fundamental principle of freedom of contract. It fails to give due efficacy to the parties' agreement concerning the manner in which their original bargain might be modified. Martinsville Nylon Employees Council Corp. v. NLRB, 969 F.2d 1263, 1267 (D.C. Cir. 1992) (stating that the common law rule "denies to all contracting parties, no matter how sophisticated, the ability to decide for themselves whether to restrict the manner in which their agreement may be modified"). The UCC rule seeks to cure this problem by enforcing "no oral modification" provisions, without entirely foreclosing parties' ability reasonably to depart from the original terms of their agreements. See § 2-209(4) (waiver).}

Section 2-209(2) is an express statutory prohibition on oral modifications, or modifications by conduct, where the parties' written agreement contains a "no oral modification" clause.\footnote{Auto-Chlor Sys. of Minn., Inc. v. JohnsonDiversey, 328 F. Supp. 2d 980, 996 (D. Minn. 2004).} The general rule under section 2-209 is that all contractual modifications to contracts with "no oral modification" clauses must be made in writing.\footnote{Allied Sales & Serv. Co. v. Global Ind. Tech., Inc., No. 97-0017-CB-M, 2000 U.S. Dist. LEXIS 7774, at *19 (S.D. Ala. 2000).}

Subsection (2) permits parties to include additional writing requirements in their agreements beyond those imposed by the UCC's Statute of Frauds.\footnote{The UCC Statute of Frauds only requires that quantity terms be in writing. Cloud Corp. v. Hasbro, Inc., 314 F.3d 289, 297 (7th Cir. 2002); see also § 2-209 cmt. 3 ("Subsection (2) permits the parties in effect to make their own Statute of Frauds as regards any future modification of the contract by giving effect to a clause in a signed agreement which expressly requires any modification to be by signed writing. But note that if a consumer is to be held to such a clause on a form supplied by a merchant it must be separately signed.").} Parties are free to incorporate more stringent conditions for contractual modification than are required within the four corners of the UCC.\footnote{See § 2-209 cmt. 3 ("Modification or rescission' includes abandonment or other change by mutual consent [but] it does not include unilateral 'termination' or 'cancellation.'").} For example, the court in \textit{Cloud Corp. v. Hasbro, Inc.} enforced a provision requiring written consent before suppliers could modify the terms of their employer's purchase orders.\footnote{Cloud Corp. v. Hasbro, Inc., 314 F.3d 289 (7th Cir. 2002). The \textit{Cloud Corp.} court found a written modification of a purchase order valid, but in doing so stated that the written modification satisfied section 2-209. \textit{Id.} at 297.}

Subsection (3), therefore, merely provides minimum requirements for the satisfaction of subsection (2). Thus, section 2-209, unlike the common law rule, enables parties valuing certainty in their performance rights and obligations to employ a “no oral modification” provision as a mechanism of certainty in their contractual dealings.\footnote{Martinsville Nylon Employees Council Corp. v. NLRB, 969 F.2d 1263, 1267 (D.C. Cir. 1992) (stating that the enforcement of “no oral modification” clauses “enables parties who value certainty to provide for it in their written agreement while taking nothing away from parties who prefer some uncertainty”).}

b. \textbf{Waiver}

Under the UCC, an oral agreement that alters a contract containing a “no oral modification” provision is ineffective as a modification. Nonetheless, such an agreement may act as a waiver of
the “no oral modification” provision under section 2-209(4). Thus, the UCC does not completely proscribe giving effect to oral agreements to change the terms of a written contract that prohibits oral modifications. However, waiver can only be used to extinguish performance duties under the written agreement; an attempted modification that would impose additional obligations on a party will not be deemed a waiver under subsection (4). For a waiver to be effective it must “be based on words or conduct directed specifically to those provisions [sought to be modified or waived] rather than being directed simply to an underlying contractual provision.”

It is important to keep in mind that section 2-209(4) does not provide that an attempted modification or rescission will in all cases act as a waiver. An attempted modification “may operate as a waiver.” While section 2-209 does not state when a modification “may operate as a waiver,” at least one court has stated that reliance on the attempted modification implicates the waiver rule. It is also important to keep in mind that only an “attempt at [oral] modification” can act as a waiver. This “attempt” requirement is intended to prevent unintentional waivers and thereby provide appropriate protection to the parties’ bargained for exchange.

The application of section 2-209(5) is not limited to waivers resulting from invalid modifications under subsections (2) and (3). Rather, it applies to all waivers of contract terms, provided that the contract is executory. Thus, although it is an integrated part of section 2-209, subsection (5) can also be applied independent of the other subsections.

A waiver may be revoked by “reasonable notification received by the other party that strict performance will be required,” unless that party has detrimentally relied on the waiver. Thus, absent detrimental reliance limiting the other party’s ability to meet the terms as agreed before the waiver, the waiving party may retract the waiver as to future performance. However, a waiver cannot be given retroactive effect. That is, the waiving party, upon retraction of a waiver, cannot demand that performance rendered while the waiver was effective be brought up to par with the unwaived terms of the agreement.

c. The Role of Parol Evidence

117 § 2-209(4); see, e.g., Wireless Distrib., Inc. v. Sprintcom, Inc., 51 U.C.C. Rep. Serv. 2d 676 (N.D. Ill. 2003) (applying state analog of section 2-209(4), the court held that the plaintiff alleged facts sufficient to prove that Sprint waived both the substantive provisions of a “Distribution Agreement” and its no-oral-waiver clause where the parties’ course-of-conduct could not constitute a modification under subsection (2)).


119 Id. at *26 (emphasis added).

120 § 2-209(4) (emphasis added).

121 Wisconsin Knife Works v. Nat’l Metal Crafters, 781 F.2d 1280, 1286-87 (7th Cir. 1986) (“[I]f an attempted modification is effective as a waiver only if there is reliance, then both sections 2-209(2) and 2-209(4) can be given effect.”).

122 § 2-209(4).


124 Wisconsin Knife Works, 781 F.2d at 1287.

125 § 2-209(5).

Section 2-209(2) is a reiteration of the UCC’s parol evidence rule -- Section 2-202 -- with respect to modifications or rescissions conflicting with “no oral modification” provisions. The UCC rule for parol evidence closely mirrors the common law rule.

Parol evidence is ineffective as against a written agreement where it would “impose new legal obligations on or alter the existing legal obligations of the parties.” Where a final writing exists memorializing the parties’ agreement, parol evidence may be admitted only to prove consistent additional terms. Thus, parol evidence may not be used to disregard a “no oral modification” clause included in the written agreement. However, as explained above, the parol evidence rule does not preclude introduction of evidence concerning course of dealing, usage in trade or course of performance, where the evidence is offered to assist the court in interpreting the terms of the written agreement.

2. Assignment of Rights and Delegation of Performance

“[B]oth the assignment of rights and the delegation of duties are generally normal and permissible incidents of a contract for the sale of goods.” By the same token, parties are free to enter agreements prohibiting the assignment of rights and delegation of duties of performance. The presence of a valid anti-assignment or nondelegation provision renders section 2-210 inapplicable.

If the parties agree that one party’s rights or duties of performance are not assignable without the other party’s consent, any subsequent assignment without consent is necessarily invalid under section 2-210(2). This is true irrespective of whether the franchisor or manufacturer has a substantial interest in having its original obligor perform. Moreover, the franchisor or manufacturer does not have to act reasonably in electing to enforce a no-assignment provision or in refusing to consent to an assignment. For example, in James v. Whirlpool Corp., the court

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127 § 2-202 (“Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented (a) By course of dealing or usage of trade (§ 1-205) or by course of performance (§ 2-208); and (b) By evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.”).

128 See, e.g., Sagent Tech., Inc. v. Micro Sys., Inc., 276 F. Supp. 2d 464, 467 (2003) (choosing to apply the UCC rule without analyzing whether the dispute was governed by the UCC because the Maryland common law and the UCC are “nearly identical”).

129 Id. at 468.

130 § 2-202(1)(b).

131 See supra Section II.D.

132 § 2-210 cmt. 2. Section 2-210 does not purport to provide a complete statement of the law of assignment and delegation, “but is limited to clarifying a few points doubtful under [common law].” Id. cmt. 7.

133 See, e.g., Hall v. Burger King Corp., 912 F. Supp. 1509, 1538 (S.D. Fla. 1995) (citing Burger King Corp. v. Collins, No. 90-0987, slip op. at 7 (S.D. Fla. June 1, 1994)).


135 See infra Section III.B.1. The exceptions to free delegability in subsection (2) are set forth in the disjunctive; thus, an agreement prohibiting delegation is enforceable without consideration of the obligee’s interests in receiving performance from its original obligor. § 2-210(2).

136 Taylor Equip., Inc. v. John Deere Co., 98 F.3d 1028, 1034 (8th Cir. 1996).
upheld a manufacturer’s refusal of consent to assignment of a distributorship without analyzing the basis for refusal. The court stated that under the contract’s consent requirement, the manufacturer had “unlimited authority to refuse assignment” of the distributorship.138

a. Assignment

Section 2-210(1) states:

If a seller or buyer assigns rights under a contract . . . (a) . . . all rights of the seller or buyer may be assigned unless the assignment would [1] materially change the duty of the other party, [2] increase materially the burden or risk imposed on that party by the contract, or [3] impair materially that party’s chance of obtaining return performance. . . .

Thus, the general rule under the UCC is that rights of due performance may be freely assigned, subject to these three precisely delineated exceptions. A franchisor or manufacturer must prove the existence of one of these three exceptions in order to prevent assignment of a franchise or distributorship absent a no-assignment clause.140

A franchisor clearly may assign its franchise rights to a third party who is not a direct competitor of its franchisees. In Ackley v. Gulf Oil Corp.,141 a gasoline company assigned its franchise-distributorship agreements to Cumberland Farms, Inc., an operator of convenience stores. The franchisees argued that the assignment was invalid because the assignee competed directly with the franchisees in the sale of gasoline to consumers. The court disagreed, however, and held that the assignment to the franchisees’ competitor was valid because the assignee did not directly compete in the franchisees’ marketing areas.142 Moreover, where the new franchisor is a competitor of the old franchisor, there is not necessarily an increased burden or risk for the franchisee, and such assignments are therefore presumptively valid under section 2-210(1).143 However, a franchisor may not assign a franchise agreement to a direct competitor of the franchisee, since a party should not be forced to accept performance from its direct competitor.144

Where a contract provision includes an open price term, an increase in price by an assignee does not constitute an increased burden.145 In Clark v. BP Oil Co., the franchisor assigned it rights

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138 Id. at 840.
139 § 2-210(1).
140 See id.
141 726 F. Supp. 353 (D. Conn. 1989), aff’d 889 F.2d 1280 (2d Cir. 1989).
142 Id. at 363. The Petroleum Marketing Practices Act plays a significant role in the assignability of the franchise rights for gas stations by franchisors, and may preclude assignments that would be valid under the UCC. See 15 U.S.C. §§ 2801-06 (2006); see also Barnes v. Gulf Oil Corp., 795 F.2d 358 (4th Cir. 1986). This issue is outside of the scope of the application of Article 2 to franchising and will therefore not be discussed.
143 § 2-210(1).
144 Cf. In re Nedwick Steel Co., 289 B.R. 95, 98 (N.D. Ill. 2003) (“It does not matter whether an assignee/competitor has the capacity to perform or that it honestly intends to perform under the contract; the purpose of UCC 2-210(2) is to protect a party from being forced to accept performance from a competitor.”).
145 Clark v. BP Oil Co., 137 F.3d 386, 393 (6th Cir. 1998).
in the plaintiff’s franchise. The assignee then charged the dealer a substantially higher wholesale price for gasoline than the dealer had been charged by BP. The dealer argued that the price increase constituted constructive termination of the franchise. The court disagreed, and held that, the increase was not an increased burden on the franchisee sufficient to invalidate the assignment because the price of gasoline was an open price term in the franchise agreement.146 The \textit{Clark} assignee owned and operated a gas station down the street from the dealer’s station; thus, presumably the dealer could have argued against the assignment as an invalid transfer of franchise rights to its direct competitor.147 Based on the later decision of \textit{In re Nedwick Steel Co.}, this might have resulted in a favorable ruling for the dealer.148

b. \textbf{Delegation}

Section 2-210(2) states: "If the seller or buyer delegates performance of its duties under a contract . . . (a) A party may perform its duties through a delegate \[1\] unless otherwise agreed or \[2\] unless the other party has a substantial interest in having the original promisor perform or control the acts required by the contract."149 Thus, delegation of performance obligations is permitted under the UCC unless the contract includes a term prohibiting delegation,150 or performance by a delegate "would be unsatisfactory to the obligee."151

i. \textbf{Factors For Delegability Under Section 2-210(a)}

If a Distributorship Agreement prohibits delegation by the franchisee absent the franchisor’s consent, any unapproved delegation is invalid and a breach of contract. Absent such limitations, in determining whether obligations may be delegated, courts will weigh the policy of free alienability of commercial contracts against the need to protect obligees from being forced to accept performance that was not bargained for.152 In this way, the principle of freedom of contract weighs both in favor of, and against, the delegability of contractual duties. Where a relationship of trust and confidence exists between the original parties, or where the obligee has placed a degree of trust and confidence in the obligor to meet the terms of the agreement, courts will generally bar delegation of the obligor’s duty to perform.153

A distributor cannot delegate its duty of performance under an exclusive distributorship agreement to its competitor in the marketplace, or a wholly owned subsidiary of a competitor, without the manufacturer’s consent.154 However, in a non-exclusive relationship, and where the

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146 \textit{id.}
147 \textit{id.} at 389.
148 \textit{See supra} note 39 and accompanying text.
149 § 2-210(2).
150 § 2-210(2)(d). ("A contractual term prohibiting the delegation of duties otherwise delegable under paragraph \(a\) is enforceable, and an attempted delegation is not effective.").
151 \textit{Sally Beauty Co.}, Inc. v. Nexxus Prod. Co., Inc., 801 F.2d 1001, 1007 (7th Cir. 1986) ("[T]he UCC . . . bars delegation of duties if there is some reason why the non-assigning party would find performance by a delegate a substantially different thing than what he had bargained for.").
152 \textit{id.} at 1006-07.
154 \textit{Sally Beauty Co.}, 801 F.2d at 1007-08.
manufacturer has multiple distributors, one distributor’s delegation of its duty of performance to a competitor does not compromise the obligee’s interests, and thus a delegation is valid, provided there is no evidence of bad faith by the competitor after delegation. This is because the manufacturer’s other distributors remain in direct competition with the delegate, and thus there is no enhanced risk to the manufacturer’s realization of potential profits.\textsuperscript{155}

ii. Adequate Assurance of Due Performance

An obligee “may treat any delegation of duties as creating reasonable grounds for insecurity and may without prejudice to its rights against the assignor demand assurances from the assignee under section 2-609.”\(^{156}\)

Since a demand for assurance is per se reasonable under section 2-210(2)(c), the only issue that arises is what constitutes adequate assurance by a delegate. Adequacy is determined based upon the circumstances of the particular case,\(^{157}\) and the obligee must exercise good faith based upon commercial standards in deciding whether to accept a delegate’s proffered assurance.\(^{158}\)

While an oral promise may under appropriate circumstances constitute adequate assurance, where a delegation has occurred, it is not adequate assurance for the obligor simply to state to the obligee that the delegate will be able to meet the original terms of the contract.\(^{159}\)

3. Unconscionability

Courts may refuse to enforce unconscionable contracts and contract terms. When faced with one or more unconscionable terms, courts may refuse to enforce either the entire contract or only the unconscionable terms.\(^{160}\) “[T]he parties shall be afforded a reasonable opportunity to present evidence as to [the contract’s] commercial setting, purpose, and effect to aid the court in making the determination” as to a contract’s enforceability.\(^{161}\)

The test for unconscionability is whether “in light of the general commercial background and the commercial needs of the particular trade or case, the term or contract involved is so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract.”\(^{162}\) There are two elements to unconscionability, both of which must be present in some

\(^{156}\) § 2-210(2)(c); see also § 2-609 (“If reasonable grounds for insecurity arise with respect to the performance of either party, the other may demand in a record adequate assurance of due performance and until the party receives the assurance may if commercially reasonable suspend any performance for which it has not already received the agreed return.”). The adequate assurance analysis is irrelevant where a distributor attempts to delegate its duty of performance under an exclusive dealership agreement. In such cases delegation is per se invalid where the obligee objects, and thus no amount of assurance can validate the delegation. See In re Nedwick Steel Co., Inc., 289 B.R. 95, 98-99 (N.D. Ill. 2003).

\(^{157}\) § 2-609(4).

\(^{158}\) § 2-609 cmt. 4.


\(^{160}\) § 2-302(1).

\(^{161}\) § 2-302(2).

\(^{162}\) § 2-302 cmt. 1; see also Gladding v. Langrall, Muir & Nopphinger, 401 A.2d 662, 664 (Md. 1979) (“[W]hen determining whether an entire contract or any of its parts is so unconscionable as to justify its judicial rescission or cancellation, the matter will not be judged by hindsight but by the situation as it existed at the time the bargain was struck.”). The authors recognize the circularity of this definition; but nonetheless, it is widely accepted. The doctrine of unconscionability can best be understood in the terms of its application, and the dual requirements of procedural and substantive unconscionability.
proportion in order for a contract term to be deemed unconscionable. 163 These are procedural unconscionability and substantive unconscionability.164

a. **Procedural Unconscionability**

For a contract term to be procedurally unconscionable, there must have been some defect in the bargaining process preceding its acceptance. Courts consistently recognize three factors relating to procedural unconscionability: the placement or appearance of the clause in the contract,165 the parties’ relative levels of sophistication,166 and the availability of alternatives to the complaining party.167

Contracts of adhesion — form contracts which a party is forced to accept or reject without negotiation — are sometimes held to be procedurally unconscionable. However, procedural unconscionability requires more than the mere fact that the agreement is proposed on a pre-written form.168 One of the above listed factors must also be present. Several courts have recognized that franchise agreements can be unconscionable adhesion contracts where a gross disparity of bargaining power exists between the franchisor and franchisee.169 What occurs more often in franchise cases, however, is that courts will enforce franchise agreements offered on a “take it or leave it” basis because the franchisee is unable to prove the presence of any of the other elements of procedural unconscionability.170

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163 Some courts also state that a party’s failure to read a contract without an excuse bars any later claims for unconscionability. See, e.g., Jones Distrib. Co. v. White Consol. Indus., Inc., 943 F. Supp. 1445, 1459 (N.D. Iowa 1996).

164 Id. at 1460 (“[T]wo factors must be present in order to establish that a contract or one of its provisions is unconscionable: (1) the terms of the contract are unfair and unreasonable, i.e., the terms are ‘substantively unconscionable,’ and (2) the individualized circumstances of the parties were such that no voluntary meeting of the minds was possible, i.e., there was ‘procedural unconscionability.’”).

165 See e.g., KBQ, Inc. v. E.I. du Pont de Nemours & Co., 6 F. Supp. 2d 94, 101 (D. Mass. 1998). A term that is buried in a lengthy contract or that is obscurely phrased may be procedurally unconscionable. Id.

166 See Kubis & Perszyk Assoc., Inc. v. Sun Microsystems, Inc., 680 A.2d 618 (N.J. 1996) (“Though economic advantages to both parties exist in the franchise relationship, disparity in the bargaining power of the parties has led to some unconscionable provisions in the agreements.”); see also KBQ, Inc., 6 F. Supp. at 94 (finding no unconscionability where plaintiff was experienced as a franchise distributor with a college degree, was a sophisticated businessman and understood the meaning of the clause in question); Weaver v. Am. Oil Co., 276 N.E.2d 144, 146 (Ind. 1971) (holding agreement between oil company and gas station lessee was procedurally unconscionable because the plaintiff had only a year and a half of high school education, and “was not one who should be expected to know the law or understand the meaning of technical terms”).

167 See, e.g., Choice Hotels Int’l, Inc. v. Chewl’s Hospitality, Inc., Bus. Franchise Guide (CCH) ¶ 12,721 (4th Cir. 2003) (stating that where the franchisee chooses one franchisor over another because of an increased profitability, there is no procedural unconscionability).


169 See, e.g., Beachler v. Amoco Oil Co., 112 F.3d 902, 904 (7th Cir. 1997) (stating that a vast disparity of bargaining power exists between franchisors and franchisees in the petroleum distribution industry). Here too, it is important to recognize that a disparity in bargaining power is insufficient in and of itself to prove procedural unconscionability. See Reynolds Publishers v. Graphics Fin. Group, Ltd., 938 F. Supp. 256 (D.N.J. 1996).

170 See, e.g., Cooper v. MGM Inv. Co., 367 F.3d 493, 502 (6th Cir. 2004) (finding a franchise agreement offered on a “take it or leave it” basis was not adhesive because the plaintiff was unable to prove that she lacked alternatives to entering into a franchise relationship with the franchisor).
b. **Substantive Unconscionability**

In order to be unenforceable under section 2-302, a contract term must also be substantively unconscionable. In common parlance, the term must be so unfavorable to one party as to “shock the conscience.”

“An unconscionable bargain is one which no man in his senses and not under delusion would make on the one hand, and . . . no honest and fair man would accept on the other.”

For example, agreed remedies provisions sometimes have been found to have been unduly punitive and therefore substantively unconscionable.

i. **Choice of Forum and Arbitration Provisions**

The enforceability of choice of forum and arbitration provisions depends largely upon the circumstances surrounding the parties’ relationship. For example, in *Domingo v. Ameriquest Mortgage Co.* the Ninth Circuit found a forum selection clause to be substantively unconscionable under section 2-302 because it required Ameriquest employees located in Hawaii to arbitrate any and all claims in California. In striking down the choice of forum provision, the court noted that it effectively precluded the employees from bringing small claims against Ameriquest because the expense of travel would exceed any relief obtained in arbitration.

ii. **Termination Rights**

Termination rights unreasonably favorable to franchisors may be deemed substantively unconscionable under section 2-302, particularly where the franchisee is in a subordinate bargaining position to the franchisor. For example, in *Shell Oil Co. v. Marinello*, the court held a franchise agreement substantively unconscionable because it provided that the franchisor could terminate its relationship with a franchisee-gas station without cause on ten days notice. The court also noted that a gross disparity in bargaining power existed between the parties.

In contrast, where a termination provision applies equally to both parties, it is unlikely to be deemed unconscionable. The court in *Communications Maint., Inc. v. Motorola, Inc.* upheld a contract clause that provided for termination by either party without cause upon thirty days notice. Likewise, the court in *Jones Distribution Co. v. White Consolidated Industries, Inc.* held that a
mutual at-will termination clause in a distributorship agreement was not unconscionable because, “the clause gives the distributor an easy way to cut the knot should he be presented with an opportunity to secure a better distributorship from another manufacturer.”

iii. Contractual Limitations Provisions

In Mobil Oil Corp. v. Earhart Petroleum, Inc., the U.S. Court of Appeals for the Fourth Circuit upheld a term in a distributor agreement limiting only the distributor’s ability to bring a claim arising under the agreement to twelve months from the date of the grievance. The court stated that there was no procedural unconscionability because there was no gross disparity in bargaining power between Mobil and the sophisticated distributor. There was also no substantive unconscionability because, “[w]hile the disparity in the time allowed to file suit certainly favors Mobil, the inequality is not so great as to shock the conscience.” However, it should be noted that contractual provisions shortening the period in which a party may bring suit may be unenforceable under various states’ constitutions, or statutory provisions other than state versions of the UCC.

C. Warranties and Indemnification

Warranties are of great importance to sellers and buyers of products. The UCC is drafted to protect the expectations of buyers while providing sellers with freedom to limit the risks that they assume in providing their products to the public. A warranty is a promise related to a product made by either a manufacturer or a seller to a buyer. Warranties in relation to the sale of goods are express or implied in law.

Courts regularly construe franchise agreements in conjunction with the UCC’s warranty provisions. By way of example, in Liberty Lincoln-Mercury, Inc. v. Ford Motor Co., a case involving the New Jersey Franchise Practices Act, the U.S. Court of Appeals for the Third Circuit utilized the UCC’s legal warranty principles, and even the UCC’s definition of the term “warranty,” in construing the rights and obligations of the parties.

However, it should be noted, as a threshold matter, that the warranties discussed here do not apply to the sale of franchise rights, separate from goods. For example, in JRT, Inc. v. TCBY Sys., the court ruled that the implied warranty of merchantability was not applicable to the franchise agreements between a yogurt franchisor and a franchisee because the agreements were not “transactions in goods” within the meaning of section 2-102. The court found that the primary purpose of the agreements was not to sell goods, but rather to enable the franchisee to establish the franchise through the use of the franchisor’s services and trademarks, and therefore that the implied warranty of merchantability did not apply.

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181 Id. at 1462.
182 Id. (quoting Corens wet, Inc. v. Amana Refrigeration, Inc., 594 F.2d 129, 138-39 (5th Cir. 1979)).
184 Id. at *14.
185 STEWART MACAULAY, CONTRACTS: LAW IN ACTION 555 (The Michie Co. 1995).
186 171 F.3d 818 (3d Cir. 1999).
187 52 F.3d 734 (E.D. Ark. 1994).
1. **Express Warranties**

Express warranties are warranties between the seller and the immediate buyer with whom the seller has a contractual relationship.\(^{188}\) These warranties “rest on the ‘dickered’ aspects of the individual bargain, and go . . . clearly to the essence of the bargain . . .”\(^{189}\) Under the UCC, an “express warranty” is defined to include:

(a) any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.

(b) any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.

(c) any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.\(^{190}\)

The UCC does not require the formal use of words of promise or that the seller have any specific intention to grant a warranty, but rather only that the substance of the sale agreement contain a promise that the goods will conform to the description, sample or model.\(^{191}\)

Three sections of the UCC relating to express warranties – Sections 2-313, 2-313A, and 2-313B – cover both face-to-face transactions and transactions involving a remote purchaser:

a. **Express Warranties by Affirmation, Promise, Description, or Sample**

Section 2-313, adopted by all fifty states, provides that express warranties can be created in three ways. First, any affirmation of fact or promise made by the seller to the buyer, which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods will conform to the affirmation or promise; second, any description of the goods which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model; and third, any sample or model that is made part of the basis of the bargain creates an express warranty that the whole of the goods will conform to the sample or model. Section 2-313 also cautions that a seller need not use formal terms like “warranty” in order for an express warranty to arise.

Under any of the foregoing circumstances, a warranty is created regardless of whether the seller intended to create one.\(^{192}\) In *Pennsylvania Gas Co. v. Second Bros., Inc.*,\(^{193}\) the court found

\(^{188}\) § 2-313 cmt. 1.

\(^{189}\) Id. cmt 3.

\(^{190}\) § 2-313.

\(^{191}\) *Liberty Lincoln-Mercury*, 171 F.3d at 824.

\(^{192}\) § 2-313 cmt. 5.
that statements in a seller’s promotional brochure that the product was “completely safe,” “absolutely cuts investment, installation and operating costs,” and “ideally meets the needs of the specialized application in motels” were affirmations of fact constituting express warranties. Likewise, in Tecnoclima, S.P.A. v. PJC Group of New York, Inc., the court found that the specifications provided by the manufacturer to the distributor, which included settings for the use of two products in conjunction, may have created express warranties regarding their conjunctive use despite the existence of other express warranties which provided only that they functioned properly as separate units.

No particular reliance on affirmations or statements of fact need to be shown for a warranty to be created. For example, in Lithuanian Commerce Corp. v. Sara Lee Hosiery, the court refused to rule that a representation about a product was not an express warranty despite the presentation of evidence tending to show that the distributor knew the representations were false and therefore did not rely on them.

Section 2-313 does provide, however, that a mere opinion or affirmation of the goods’ value will not create an express warranty. Thus, in Omega Engineering, Inc. v. Eastman Kodak Co., the court found that statements that a product was “perfect” were more akin to mere opinion or commendation of the goods and therefore did not create a warranty.

In 2003, the American Law Institute and the National Conference of Commissioners on Uniform State Laws significantly amended section 2-313. While no state has adopted the amended section, it includes language which clarifies that it applies only to parties in privity. Additionally, section 2-313 now provides that a remedial promise made by a seller is enforceable by the immediate buyer even if the remedial promise is not part of the basis of the bargain.

b. Express Warranties to Remote Purchasers

The 2003 amendments added two new sections -- 2-313A and 2-313B -- both of which create statutory obligations for sellers to remote purchasers of new goods sold in the normal chain of distribution. If Revised sections 2-313A and 2-313B are adopted, a manufacturer that sells a product through a distributor will have certain statutory obligations to the ultimate purchaser.

Revised section 2-313A deals with pass-through warranties, which arise when a manufacturer sells goods in a package to a retailer and includes in the package documentation that sets forth the obligations which the manufacturer undertakes in favor of the end user. An obligation

(continued)

194 Id. at 263.
198 Section 2-103(n) as amended defines the term “remedial promise” as a promise by the seller to repair or replace goods or to refund all or part of the purchase price of goods upon the happening of a specified event. § 2-103 (2003).
199 § 2-313.
under revised section 2-313A arises only if the seller makes an affirmation of fact or promise concerning the goods, provides a description concerning the goods, or makes a remedial promise; the affirmation, promise, description or remedial promise is in a record packaged with or accompanying the goods; and the seller reasonably expects the record to be, and the record is, furnished to the remote purchaser.

Revised section 2-313B governs obligations to remote purchasers created by advertising or similar communication. An obligation under this section is created if the seller, via the communication, makes an affirmation of fact or promise concerning the goods, provides a description concerning the goods, or makes a remedial promise and the remote purchaser enters into the transaction with the knowledge and expectation that the goods will conform to the affirmation, promise, or description, or the seller will perform the remedial promise.

As under Original section 2-313, formal words of warranty are not required in order to create an express warranty under either revised section 2-313A or 2-313B. Moreover, while no state has officially adopted either section, some courts have applied the doctrines reflected in these sections. In *Scheuler v. Aamco Transmissions, Inc.*, the court concluded that advertising may be the basis of or form a part of an express warranty even when the advertising was done by the franchisor and not the franchisee. The *Scheuler* court held that a consumer can recover for breach of an express warranty against a franchisor despite the lack of privity when the consumer relied upon the franchisor’s advertising.

2. Implied Warranties

The UCC provides for two types of implied warranties, the warranty of merchantability and the warranty of fitness for a particular purpose. Implied warranties are created to protect a buyer’s interest in the product that he or she is purchasing. The implied warranty of merchantability protects a buyer’s understanding that the product will do what it is expected to do and the implied warranty of fitness for a particular purpose protects a buyer’s understanding that the product will perform the function the seller represented it would perform. A contract can have both the implied warranty of merchantability and the implied warranty of fitness for a particular purpose, in addition to containing express warranties.

a. The Implied Warranty of Merchantability

Section 2-314 creates a warranty that the goods will be merchantable when the seller is a merchant with respect to goods of that type, and the seller did not exclude or modify such a warranty under section 2-316. The major issues in analyzing the applicability of the implied warranty in a franchise relationship are whether the franchisor is a “seller” or “merchant” within the meaning of the UCC. One must also consider the scope of the franchisor’s involvement in the

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201 Id. at 51 (quoting 2 LOUIS R. FRUMER & MELVIN I. FRIEDMAN, PRODUCTS LIABILITY § 16.04(4)(a) (1984)).

202 § 2-315 cmt. 2.

203 Under section 2-104(1), a merchant is essentially a person that deals in goods of the kind involved in the transaction. § 2-104(1).
manufacture, marketing and sale of the product, and whether the defect existed when the franchisor had control over the defective product or design.204

In Buckert v. Petrol Plus of Naugatuck, Inc., General Motors designed a set of performance criteria for automatic transmission fluid, and created a licensing program by which it permitted third parties to use the trade name for that product, “Dexron II”, to produce and market products under the common trade name, but using the manufacturer’s own formulation. Other than designing the specifications, GM had no involvement in the manufacture or distribution of the product. In one instance, a licensee purchased a product from a third party manufacturer which was sold under the name Dexron II, but which did not actually meet GM’s performance criteria. In finding that GM had no liability under an implied warranty theory, the court found that because GM lacked control over the manufacturing operations and over the ultimate sale of the product, it did not meet the UCC’s definition of a “seller” or “merchant.” That fact, coupled with its lack of involvement in the stream of commerce, absolved GM from any liability under the implied warranty of merchantability.

In contrast, the court in Harris v. Aluminum Co. of America205 did impose liability on a franchisor for breach of the implied warranty of merchantability. There, the plaintiff sued both Coca-Cola and its licensed franchisee, a bottling company, after a twist-off aluminum cap blew off a soft drink bottle and blinded her in one eye. In its motion to dismiss for failure to state a claim, Coca-Cola argued that it could not be directly liable to the injured consumer for breach of the warranties of merchantability and fitness for a particular purpose because it had only supplied the Coke syrup and did not manufacture or sell the ultimate product. The plaintiff argued that the franchisor was directly liable because it set the requirements and specifications for bottling the beverage, caused the product to enter the stream of commerce, and engaged in extensive advertising to promote the sales of the product. In denying Coca Cola’s motion to dismiss, the court concluded that the franchisor may be directly liable for breaches of the implied warranties of merchantability and fitness for a particular purpose if the soft drink package was unreasonably dangerous for its ordinary use, and the bottling requirements and specifications for the packaging were under the franchisor’s control.206

Assuming that the implied warranty of merchantability applies, section 2-314 lists six factors which the goods must satisfy to be considered “merchantable”:

1. the goods must pass without objection in trade under the contract description, meaning they must be suitable for trade;

2. the goods, if fungible, must be of average quality within the description;

3. the goods must be fit for their ordinary purpose;

204 See Buckert v. Petrol Plus of Naugatuck, Inc., 579 A.2d 26 (Conn. 1990) (refusing to extend liability under a theory of breach of the implied warranty of merchantability to a trademark owner who had no involvement in the manufacturer or distribution of a defective product other than establishing the specifications with which the manufacturer and distributor failed to comply).


206 id. at 1027-29.
4. individual units of goods must be of even kind, quality, and quantity, subject to variations permitted by the agreement;

5. the goods must be adequately contained, packaged, and labeled as the agreement requires; and

6. the goods must conform to promises or affirmations of fact made on the container or label.\textsuperscript{207}

In franchise cases, courts apply these factors to ensure the quality of goods sold by the franchisor to the franchisee and, in certain circumstances, to provide redress to the public directly against franchisors or licensors as noted above.

Under the implied warranty of merchantability, goods sold must be fit for their ordinary, intended purpose. One of the best known examples of the application of the implied covenant of merchantability to a franchisor is found in Holowaty v. McDonald’s Corp.\textsuperscript{208} There, the plaintiff sustained second degree burns after spilling hot coffee on her lap while exiting a McDonald’s drive-thru. The plaintiff sued franchisor McDonald’s Corporation, alleging (1) that the coffee was unreasonably dangerous because it was hotter than what was reasonably necessary; and (2) that McDonald’s Corporation breached various duties in setting the brewing specifications for its franchisee’s coffee products at such high temperatures. The court disagreed, holding that the implied warranty of merchantability is only breached when a product is defective to a normal buyer making a normal and ordinary use of the product. A product is not defective when it is safe for normal handling and consumption and is prepared in accordance with industry standard.\textsuperscript{209}

The implied warranty of merchantability does not apply in the presence of a minor defect or when the product fails to perform normally under extreme conditions.\textsuperscript{210} For example, in Ponderosa System, Inc. v. Brandt\textsuperscript{211} a steak house franchisor sued one of its franchisees for supply and royalty payments due under the franchise agreement. The franchisee counterclaimed, alleging a breach of the implied warranty of merchantability because the meat products sold by the franchisor were of inferior quality and otherwise defective. The franchisor appealed a jury verdict in the franchisee’s favor asserting that the trial court erred by admitting into evidence a series of reports from various franchisees about defective and substandard meat products. The U.S. Court of Appeals for the Tenth Circuit disagreed, reasoning that the reports were probative to show that the franchisor’s products were not of sufficient quality to “pass without objection in trade under the contract description” and, thus, were not merchantable within the meaning of section 2-314.\textsuperscript{212}

\textsuperscript{207} § 2-314.

\textsuperscript{208} 10 F. Supp. 2d 1078 (D. Minn. 1998).

\textsuperscript{209} \textit{Id.} at 1086-87.


\textsuperscript{211} 767 F.2d 668 (10th Cir. 1985).

\textsuperscript{212} \textit{Id.} at 671-72.
Courts have held that claims under the implied warranty of merchantability may be foreclosed if the purchaser has used the allegedly deficient product for a substantial time or has renewed purchase agreements for the product. In *Kristy’s, Inc. v. Allied Products Corp.*, the court concluded that the implied warranty of merchantability could not arise after an extended period following the purchase of the product. The court also noted that the successor to the manufacturer could not be held liable for the predecessor’s warranty obligations because it explicitly disclaimed that liability in the agreement of purchase for the predecessor’s assets.

b. **The Implied Warranty of Fitness for a Particular Purpose**

Section 2-315 provides an implied warranty of fitness for a particular purpose. This warranty arises when the seller knows of a particular purpose for which the goods are required and the buyer relies on the seller’s expertise in selecting suitable goods for that purpose. The obligation is limited, however, in that it can be excluded or modified under section 2-316.

The implied warranty of fitness for a particular purpose differs from the implied warranty of merchantability in that it applies only to the “particular purpose” of the product, and not the ordinary purpose for which the goods are to be used. The particular purpose “envisages a specific use by the buyer which is peculiar to the nature of his business.”

Evidence of a special purpose outside of the ordinary purpose for which the goods are to be used is required to trigger protection of the implied warranty of fitness for a particular purpose. In *Lithuanian Commerce Corp., Ltd. v. Sara Lee Hosiery*, the court rejected a claim of implied warranty of fitness for a particular purpose since the plaintiff’s evidence encompassed only the regular purpose of the product. The court found that the implied warranty of merchantability applied and not the implied warranty of fitness for a particular purpose. Moreover, in *Cooperative Power Ass’n v. Westinghouse Electric Corp.*, the court held that to be successful on a claim of implied warranty of fitness for a particular purpose the party must establish that the product was not simply defective, but rather defective as to a particular purpose.

In addition to establishing a particular purpose, the buyer must establish that it in fact relied upon the seller’s expertise. In *Plasco, Inc. v. Free-Flow Packaging Corp.*, the court refused to impose the implied warranty of fitness for a particular purpose in light of evidence that the buyer conducted its own tests on the inadequate product.

3. **Exclusion or Modification of Warranties**

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214 Section 2-315 was unchanged by the 2003 amendments.

215 § 2-315 cmt. 2.

216 *Id.*


218 60 F.3d 1336 (8th Cir. 1995).

219 § 2-315 cmt. 1.

220 547 F.2d 86 (8th Cir. 1976).
Both express and implied warranties can be disclaimed under section 2-316, although
disclaimers of express warranties are disfavored. If the disclaimer and an express warranty are
inconsistent, the express warranty will govern.\textsuperscript{221} On the other hand, the UCC freely permits the
elimination of implied warranties provided certain conditions are met.

Section 2-316 as amended provides that a disclaimer of the implied warranty of
merchantability in a consumer contract must be in a record, must be conspicuous, and must use
understandable language that states “the seller undertakes no responsibility for the quality of the
goods except as otherwise provided in this contract.” Similarly, a disclaimer of the implied warranty
of fitness for a particular purpose in a consumer contract must be in a record, must be conspicuous,
and must use understandable language that states “the seller assumes no responsibility that the
goods will be fit for any particular purpose for which you may be buying these goods, except as
otherwise provided in this contract.” The previous version of section 2-316 did not have the specific
language requirements but did require that the disclaimer be in writing and be clear and
conspicuous.

Both the original and revised versions of section 2-316 endorse usage of stock terms like
“as is” or “with all faults” in order to disclaim warranty liability. However, under the amended
version, an “as is” disclaimer in a consumer contract must be conspicuously set forth in a record. In
\textit{Dallas Aerospace, Inc. v. CIS Air Corp.},\textsuperscript{222} the court determined that the clause “AS IS” in capital
letters was sufficiently conspicuous to negate all implied warranties concerning the condition of the
goods.

Regardless of whether the disclaimer is in specific language or stock terms, the purpose of
the conspicuousness requirement is to provide fair notice to the buyer that the implied warranty has
been disclaimed.\textsuperscript{223} Language is considered conspicuous when it is printed in all capital letters,
when it appears in larger type than the terms around it, or when it is in boldface type.\textsuperscript{224}

In addition to the use of specific or stock language to disclaim a warranty, both versions of
section 2-316 provide that implied warranties can be excluded or modified by course of dealing,
course of performance, or usage in trade,\textsuperscript{225} or by a buyer’s opportunity to perform an examination
which would have revealed the defects.\textsuperscript{226}

\section*{IV. BREACH AND REMEDIES UNDER ARTICLE II}

\subsection*{A. Significance of the Franchise Agreement}

In any relationship in which the predominant purpose is the sale of goods, Article 2
establishes rules governing breach and the consequent remedies. Thus, a franchise relationship
which falls in that realm (e.g., a motor vehicle franchise) is subject to those rules. However, by its

\textsuperscript{221} § 2-316(1).
\textsuperscript{222} 352 F.3d 775 (2d Cir. 2003).
\textsuperscript{224} Stevenson v. TRW, Inc., 987 F.2d 288 (5th Cir. 1993).
\textsuperscript{225} § 2-316(3)(c).
\textsuperscript{226} § 2-316(3)(b).
express terms, the UCC primarily establishes the franchise agreement as the governing document for determining both breach and remedies.\(^{227}\)

This governance is not, however, exclusive. The UCC, for example, does not permit the franchise agreement to disclaim obligations of good faith, diligence, reasonableness and care.\(^{228}\) The contract can, however, establish the standards by which performance of these obligations is to be measured, as long as the standards are not manifestly unreasonable.\(^{229}\) Moreover, even though a franchise agreement may speak to a particular issue of breach or remedy, the UCC provisions are often useful in addressing the issues and creating presumptions, and should not be overlooked by the franchise attorney for that purpose.\(^{230}\) Furthermore, the UCC’s doctrine of unconscionability may possibly be available as a line of attack for the franchisee.\(^{231}\)

Of course, the franchise agreement is always subject to “[a]pplicable state and federal franchise statutes; and [a]pplicable case law under those statutes.”\(^{232}\) For example, the assertion of breach or the exercise of a particular remedy by a franchisor may be trumped by its covenant of good faith and fair dealing under statutes and/or case law.\(^{233}\)

B. Breach

The franchise agreement customarily sets forth the various obligations of both franchisor and franchisee that must be satisfied during the course of the relationship. Examples of these include:

\begin{itemize}
  \item \textbf{Franchisor Obligations:}
    \begin{itemize}
      \item a) An obligation to supply product and training;
      \item b) An obligation to advertise and promote the product or brand;
      \item c) An obligation to indemnify the franchisee for product liability claims.
    \end{itemize}
  \item \textbf{Franchisee Obligations:}
    \begin{itemize}
      \item a) An obligation to promote and sell the product;
      \item b) An obligation to maintain adequate franchise facilities;
    \end{itemize}
\end{itemize}

\(^{227}\) § 1-102(3); see \textit{also} Jon-T Chems., Inc. v. Freeport Chem. Co., 704 F.2d 1412 (5th Cir. 1983).


\(^{229}\) § 1-102(3); \textit{Vlases v. Montgomery Ward & Co.}, 377 F.2d 846 (3d Cir. 1967) (stating that standards of performance may be modified unless unreasonable).

\(^{230}\) For example, the course of dealing (§ 1-205(1)) between the franchisor and franchisee could have a significant bearing as to whether a breach under the franchise agreement has occurred.

\(^{231}\) \textit{Ashland Oil, Inc. v. Donahue}, 223 S.E.2d 433 (W. Va. 1976) (non-renewal of franchise agreement was the direct result of disparity in bargaining power between the parties and, therefore, is unconscionable and void as against public policy); see \textit{also} \textit{Schweber Elecs. v. Nat’l Semiconductor Corp.}, 850 P.2d 119, 125 (Ariz. Ct. App. 1992).

\(^{232}\) § 1-103.

An obligation to maintain adequate capital and personnel.

Whether a particular obligation has been breached is a function of the specific language in the franchise agreement, as affected by the UCC and other applicable law.

For example, a franchise agreement will typically impose an obligation on a franchisee to maintain an adequate and acceptable facility for the conduct of its business. In the case of a motor vehicle franchise, this may take the form of elaborate facility guidelines for the display of vehicles, the storage of parts and accessories, administrative offices and the service of vehicles. These guidelines will likely entail minimum square footage and design requirements. It is common for an issue over facility compliance to arise.

To be sure, whether a franchisee has satisfied or breached its facility or other franchise requirements is a function of the precise language in the franchise agreement. However, the UCC doctrine of good faith is relevant to that determination. The UCC also looks to the course of dealing between the franchise parties and the usage of trade. Furthermore, the applicable state franchise statute and relevant case law may address the issue. Even the doctrine of good faith, under either the common law or the applicable franchise statute, may not save a franchisee from breach where it has consistently breached its obligations.

It is also important to consider the issue of cure. It is customary for a franchise agreement to afford the breaching party an opportunity to cure. For example, one well-known donut franchise agreement gives the franchisee various cure periods, depending on the nature of the breach. Many franchise agreements will adopt the

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234 § 1-203; Zapatha v. Dairy Mart, Inc., 408 N.E.2d 1370, 1375 (Mass. 1980) (declaring that the UCC good faith requirement applies to franchise agreements).

235 See § 1-205.

236 See, e.g., N.J. Stat. Ann. § 56: 10-7.4(a) (West 2006) (a motor vehicle franchisor may not “impose . . . unreasonable facilities . . . upon a motor vehicle franchisee”); Bronx Auto Mall, Inc. v. Am. Honda Motor Co., Inc., 934 F. Supp. 596 (S.D.N.Y. 1996), aff’d 113 F.3d 329 (2d Cir. 1997) (finding franchisor’s facility requirements were unreasonable). It is noteworthy that the court in *Bronx Auto Mall* also relied, in part, on the good faith requirement of the UCC. *Id.* at 611-12 & n.24.

237 See, e.g., Woodward v. General Motors Corp., 298 F.2d 121, 128 (5th Cir. 1962) (“We do not think that the good faith requirement, whether viewed in or outside of the context of coercion, prevents a manufacturer from terminating a contract with a dealer where the dealer has, over a long period of time, violated a valid and material clause of the contract and has failed to comply with the continuing insistence of the manufacturer upon performance.”); see also Savannah, Inc. v. Chrysler Motors Corp., 357 F.2d 429 (5th Cir. 1966) (holding that the [applicable franchise statute] was not intended to prohibit the threat of cancellation of a franchise if there is a prolonged failure on part of franchisee to comply with its franchise requirements).

238 For example, the agreement provides a thirty day cure for most breaches, but only a seven day cure for non-payment and just a twenty-four hour cure for a health or safety violation.

cure period of the relevant franchise statute. Therefore, there may be no breach at all if a cure is timely effected.

The UCC may affect the issue of cure as well. For example, section 2-609 entitles a franchisee accused of insolvency to a reasonable opportunity to provide an adequate assurance of due performance.240 Similarly, section 2-611 gives a repudiating party the opportunity to retract their repudiation.

C. REMEDIES

1. General

As with breach, the remedies available to franchisor and franchisee are, to a certain extent, controlled by the franchise agreement. The franchise agreement typically contains numerous and substantial remedies for the franchisor in the event of the franchisee’s breach. In addition, these provisions usually include a statement that the contractual remedies are not exclusive and are separate from any additional remedies provided in applicable law. Conversely, the franchise agreement, which is usually drafted by the franchisor and mostly sensitive to its interests, is usually devoid of meaningful provisions governing the remedies of a franchisee in the event of franchisor breach.

Furthermore, franchise agreements will usually attempt to limit the franchisee’s remedies. The following are examples of these:

(a) No franchisor liability for the delay in providing product;
(b) No franchisor liability for the business losses sustained by the franchisee;
(c) No franchisor liability for consequential damages;
(d) The requirement of a general release upon termination of a franchise.

As a result of this disparity, the impact of the UCC on remedies in a franchise dispute will differ significantly between the remedies of the franchisor and the remedies of the franchisee. Once again, this is a function of section 1-102(3), which permits the franchise agreement to control, with the exception of the obligations of good faith, reasonableness and care. Since a typical franchise agreement contains elaborate franchisor remedy provisions, it likely governs those remedies, subject to a franchisee’s claim of bad faith and/or unreasonableness. In contrast, since most franchise agreements are either silent regarding franchisee remedies or have only limited provisions or clauses addressing them, the UCC, as well as franchise statutes, are likely to play a significant role in the determination of those remedies.

2. Franchisor Remedies

240 This period of time is not to exceed thirty days. § 2-609.
The typical franchise agreement establishes termination as the franchisor’s primary remedy in the event of franchisee breach, with extensive default provisions that justify termination, either immediately or after notice and failure to cure.

However, in virtually every franchise agreement, the franchisor’s remedies significantly extend beyond termination. These additional remedies may include:

1. The right to cease the supply of products;
2. The right to recover damages including legal fees;
3. The right to an accounting (or to do an audit); and
4. The right to seek injunctive relief.

In many cases, the franchise agreement will simply reserve the right to pursue such additional remedies as applicable law may provide. That is where the UCC may play a role.

Article 2 enumerates extensive remedial measures for a seller of a product in the event of a buyer’s breach. These remedies, which clearly apply in any franchise relationship that primarily involves the sale of goods, include:

a. Stoppage of delivery of goods.\textsuperscript{241}

b. Reclamation.\textsuperscript{242}

c. Withholding of delivery.\textsuperscript{243}

d. Resale and recovery of damages.\textsuperscript{244}

e. Cancellation.\textsuperscript{245}

The UCC also entitles the franchisor to incidental damages.\textsuperscript{246}

The UCC’s affect on a franchisor’s termination rights is, to a large extent, secondary, but nevertheless, is important to consider.

In termination disputes with an applicable state franchise statute, the courts primarily rely on that statute in adjudicating the issue. For example, in \textit{Shell Oil Co. v. Marinello},\textsuperscript{247} the New Jersey

\textsuperscript{241} § 2-702(1).
\textsuperscript{242} § 2-702(3).
\textsuperscript{243} § 2-703(a).
\textsuperscript{244} § 2-703(d).
\textsuperscript{245} § 2-703(b).
\textsuperscript{246} § 2-710.
Superior Court exclusively applied the New Jersey Franchise Practices Act\textsuperscript{248} to determine if a termination was proper. Although New Jersey is a UCC jurisdiction, the court made no mention of the UCC.\textsuperscript{249}

Where there is no applicable state franchise statute, the courts have differed on the application on the UCC. In \textit{Zapatha v. Dairy Mart, Inc.},\textsuperscript{250} the court first evaluated the franchise termination under the UCC. However, it ultimately applied a broader common law approach to define good faith. To this end, the court commented: “We thus analyze the case before us in terms of whether in terminating the agreement [franchisor] failed to act in good faith in a broader sense than the term is used in [section 1-203], or dealt unfairly with the [franchisees], and whether [franchisor] engaged in any unfair or deceptive act or practice.”\textsuperscript{251} In \textit{Hoff Supply Co. v. Allen Bradley Co., Inc.},\textsuperscript{252} the court upheld the termination without cause provisions in a franchise agreement under both common law and UCC principles.

Conversely, in \textit{Haynes Truck Service Agency, Inc. v. American Standard, Inc.},\textsuperscript{253} the court applied Texas law and held that the implied covenant of the UCC could not override the express provisions of the franchise agreement. In applying Illinois law, another court decided that the UCC does not govern the franchise relationship at all.\textsuperscript{254}

Although there are certain jurisdictions (e.g., Texas) which do not recognize the role of the UCC in franchise cases, these appear to be the exception to the rule. By and large, courts will consider the UCC to be relevant in franchise termination cases as well as other franchisor/franchisee disputes.

3. Franchisee Remedies

In franchises involving the sale of goods, the UCC could potentially have a significant impact on a franchisee’s remedies. However, it is customary for a franchise agreement to curtail those remedies to the largest extent possible. Therefore, it is important to understand the extent to which the UCC and applicable franchise law may vitiate those limitations.

Since franchise agreements are typically silent regarding a franchisee’s remedies, other than to establish a limitation on damage recovery, the UCC plays a significant role in establishing those remedies. The franchisee’s UCC rights include:

(a) Rejection of non-conforming goods;\textsuperscript{255}

(b) Revocation of acceptance;\textsuperscript{256}

\textsuperscript{248} N.J. STAT. ANN. § 56: 10-1 et seq.
\textsuperscript{249} See also Grand Light & Supply Co., Inc. v. Honeywell, Inc., 771 F.2d 672 (2d Cir. 1985).
\textsuperscript{250} 408 N.E.2d 1370, 1378 (Mass. 1980).
\textsuperscript{251} Id. at 1379.
\textsuperscript{253} 51 Fed. Appx. 786 (10th Cir. 2002).
\textsuperscript{254} McDonald’s Corp. v. Watson, 69 F.3d 36, 43 (5th Cir. 1995).
\textsuperscript{255} § 2-602.
The precise language of the remedy provision of a franchise agreement will be important to determine the extent to which these remedies are available. Where the contract purports to limit the franchisee’s remedies, the UCC help the franchisee override the limitation.

For example, a franchisee may argue that the particular limitation provision is either unreasonable or imposed in bad faith. Similarly, section 2-718 requires that a liquidated damage provision must be reasonable, and section 2-719(3) proscribes a limitation or exclusion on consequential damages where the provision is unconscionable. A limitation on consequential damages for injuries received from consumer goods is prima facie unconscionable.

Case law also circumscribes a franchisor’s ability to restrict franchisee remedies. For example, in *Schweber Electronics v. National Semiconductor Corp.*, a franchisor tried to protect itself from indemnity liability through limitation of remedies and damages clauses in its franchise agreement. The court recognized that franchisors may include limitations of damages under the Arizona analog to the UCC. However, it refused to allow a manufacturer to escape indemnity liability by adding limitation clauses to contracts with distributors and retailers. The court held that such limitation clauses must be very specific to the exact type of indemnity claim. Other

(...)continued)

256 § 2-608.

257 § 2-711(1).

258 § 2-711(1)(a).

259 § 2-713.

260 § 2-715.

261 § 2-716.

262 § 2-717.

263 This would invoke sections 1-102 and 1-103.

264 § 2-719(3).


267 Id. at 124.
jurisdictions have invalidated indemnity limitations on the basis of fairness, balancing of equities or unconscionability.\textsuperscript{268}

V. CONCLUSION

We have attempted to give the franchise practitioner a broad overview of some of the more important UCC issues arising in the franchise relationship. As noted in the introduction, even in business format franchises that the UCC does not govern, the commercial principles set forth in the UCC are helpful in addressing issues with individual franchises as well as system-wide problems.

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David L. Cahn, founder of Franchise & Business Law Group in Baltimore, Maryland, has a wide-ranging practice representing franchisors and franchisees. Mr. Cahn has represented (a) several franchisors in preparing and registering franchise offering circulars and negotiating franchise agreements; (b) numerous franchisees in evaluating and negotiating franchise agreements and real property leases; and (c) current or former franchisees in negotiation and dispute resolution proceedings with their franchisors. He also has been designated as an expert witness regarding the standard of care in representing a franchisee.

Mr. Cahn is the Vice-Chair of the Franchise and Distribution Law Committee of the Maryland State Bar Association and a member of that Association’s Business Law Section Council. He has been a presenter on several occasions at the American Association of Franchisees and Dealer’s annual convention; a facilitator at the International Franchise Association annual convention; a lecturer at franchise opportunity expositions in Maryland; and a faculty member of the program *Understanding and Negotiating A Franchise Agreement*, a joint CLE program of the Maryland and Virginia Bar Associations. Mr. Cahn, who obtained his Bachelor of Arts from Stanford University and his Juris Doctor from the University of Pennsylvania, is the author or co-author of several articles that have been published in the Forum’s *Franchise Law Journal* and *Franchise Lawyer*. During the past year he was featured in the *Baltimore Business Journal* in an article on franchise disputes and was recognized as a “Legal Eagle” by *Franchise Times*.

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Mr. Levin served as co-chair of the 2003 American Bar Association’s 26th Annual Forum on Franchising and was elected in 2001 to a three year term on the Governing Committee of the ABA’s Forum on Franchising. He was the founding Chairperson of the Franchise Law Committee of the New Jersey State Bar Association from 1997-1999. Mr. Levin served as an Articles and Topics Editor of the Franchise Law Journal from 1997-2000. He is included in the International Who’s Who of Franchise Lawyers 2004/05 (4th Edition) and 2006 (5th Edition). Mr. Levin was the only lawyer in New Jersey nominated by his peers in the national franchise bar. He was also named a “Super Lawyer” in the May 2005 and April 2006 editions of New Jersey Monthly.