Hastings Law Journal

Volume 10 | Issue 1 Article 8

1-1958

Contracts: Dealer Franchise Contracts, Limitation of Exculpatory Clause by Implied Obligation

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CONTRACTS: DEALER FRANCHISE CONTRACTS, LIMITATION OF EXCULPATORY CLAUSE BY IMPLIED OBLIGATION.

Franchise agreements between manufacturers or distributors and dealers have been the source of many vexing problems and conflicting decisions in the courts. These agreements are an important part of modern retail distribution and form the basis of operations through which the products of many large manufacturers are sold to the public. They are not strictly sales contracts nor agency contracts.[1]

Generally the dealer is required to maintain certain sales and service facilities, a specified minimum supply of the line of products, and a sales record and standard which meets the "satisfaction" of the manufacturer. In return, the dealer is accorded the privilege of selling the products and the advantages of the cooperation and advertising benefits offered by the manufacturer. Almost invariably the agreements are in a form prescribed by the manufacturer and contain terms highly favorable to him. These often have a harsh impact upon the investment and business expectations of the dealer.

In addition to determining the precise nature of the contract involved, the courts have been faced with either or both of two problems in much of the litigation involving dealer franchise agreements.[2] First, is the manufacturer under sufficient obligation to justify upholding the contract against an argument of lack of mutuality? Second, where the agreement contains an exculpatory clause, will its scope be determined by the force of its words alone, or is it possible to limit the application of the exculpatory clause so that it becomes subordinate to what the court considers the obvious over-all intention of the parties to the agreement?

In the case of *Milton v. Hudson Sales Corporation*,[3] the district court of appeal was called upon to determine the status of the California law with regard to an automobile franchise agreement which did not expressly obligate the manufacturer or distributor to deliver cars to the dealer. Milton, a former Hudson dealer, in his first cause of action against Hudson Sales Corporation, charged that Hudson in bad faith failed to supply him with his reasonable requirements of new cars in violation of the terms of the contract between them. The agreement contained an exculpatory clause to the effect that, notwithstanding acknowledgment or acceptance by the distributor (Hudson) of any order placed by the dealer (Milton), Hudson should not be liable to the dealer for any loss or damage because of failure to ship or fill such orders.

The California court determined that this was a requirements contract and that, although there was no express promise to deliver cars, an implied obligation to deliver was an inherent part of the contract. Furthermore the exculpatory clause did not relieve Hudson of liability to Milton for an *arbitrary* refusal to deliver. In its decision the court relied heavily upon *Jay Dreher Corp. v. Delco Appliance Corp.*[4] There the defendant manufacturer granted the plaintiff a franchise to sell, the contract containing a clause expressly releasing the manufacturer from liability for any loss or damage resulting from the failure of the company to fill any orders

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[1] See Kessler, *Automobile Dealer Franchises: Vertical Integration by Contract*, 66 YALE L. J. 1135 (1957).

[2] Bushwick-Decatur v. Ford, 116 F.2d 675 (2d Cir. 1940); Motor Car Supply v. General Household Utilities, 80 F.2d 167 (4th Cir. 1935); Marrinan Med. v. Ft. Dodge, 47 F.2d 458 (8th Cir. 1931).

[3] 152 Cal. App. 2d 418, 313 P.2d 936 (1957).

[4] 93 F.2d 275 (2d Cir. 1937).

of the dealer. The court held that the clause was merely "an excuse for non-performance to be exercised bona fide, not a privilege to repudiate." [5]

Under the question of whether the obligation to sell cars could be implied, Hudson relied upon earlier California cases[6] indicating the reluctance of courts to imply promises. Admittedly, it is difficult to reconcile the *Milton* decision with that of an earlier California case, *Foley v. Euless*.[7] The *Foley* case involved a contract between a packer and representatives of fruit growers. The contract prohibited the packer from accepting raisins of certain types from anyone else. The growers' representatives failed to deliver more than a very small portion of the current crop, and the portion delivered was removed before processing. In an action by the packer, it was held that there was no obligation to deliver raisins.

A rule sometimes quoted and recognized in California was laid down in the early case of *Genet v. Delaware & Hudson Canal Co.*:[8]

> [Implied promises] always exist where equity and justice require the party to do or to refrain from doing the thing in question; where the covenant on one side involves some corresponding obligation on the other; where by the relations of the parties and the subject matter of the contract a duty is owing by one not expressly bound by the contract to the other party in reference to the subject of it.

This rule was held in the *Foley* case not to be applicable to the facts. It is difficult to understand just how these facts failed to come under the *Genet* rule. If an implied promise to deliver did not exist, the question inevitably presents itself; *why* did the packer in *Foley* or the dealer in *Milton* bind himself?

The question was considered in the *Milton* decision, and the court's conclusion was similar to that in *Ellis v. Dodge*,[9] one of the very early automobile franchise cases. In the *Ellis* case, the court pointed out that since it was obviously the intention of the manufacturer to sell cars to the dealer and the purpose of the dealer to pay for and resell the cars, there was correspondingly a right to buy which must carry with it the obligation to sell. If business men go to the trouble of entering into a written agreement, there must be some purpose for that agreement. Where the instrument is capable of such interpretation a construction which will promote that purpose is to be favored.[10]

In many cases involving franchise agreements, however, a different viewpoint has been adopted. Often it has been felt that franchises are binding agreements only insofar as they furnish a basis for future dealings.[11] Other times judges have expressed impatience with contracts which "place the comparatively helpless dealer at the mercy of the manufacturer" but have felt unable to protect parties from the provisions of the contracts being litigated.[12]

With regard to the scope of the exculpatory clause, if by the contract there was an implied obligation to deliver cars, then obviously the exculpatory clause presented an ambiguity to be resolved by the court. In holding that good faith was a

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[5] *Id.* at 277.

[6] Stockton Dry Goods v. Girsh, 36 Cal. 2d 677, 227 P.2d 1 (1951); Cousins Inv. v. Hastings Clothing Co., 45 Cal. App. 2d 141, 113 P.2d 878 (1941).

[7] 214 Cal. 506, 6 P.2d 956 (1931).

[8] 136 N.Y. 593, 609, 32 N.E. 1078, 1081 (1893).

[9] 246 F. 764 (5th Cir. 1917).

[10] 12 CAL. JUR. 2d, *Contracts* § 128 (1953).

[11] Meyers Motors v. Kaiser-Fraser Sales, 178 F.2d 291 (8th Cir. 1949).

[12] Motor Car Supply v. General Household Utilities, 80 F.2d 167 (4th Cir. 1935); Ford Motor Co. v. Kirkmyer Motor Co., 65 F.2d 1001 (4th Cir. 1933).