

Grounds for Termination of Franchise Agreement in Jordan

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Abstract

Purpose: This study explores the termination of franchise agreement in Jordan. The study discusses the grounds to terminate the franchise agreement by each party whether franchisor or franchisee. Regulating the franchise sector by a specific act minimizes unfair termination and helps strengthen the franchise sector in Jordan.

Design/methodology/approach: This study is qualitative. Eleven in-depth semi-structured interviews were conducted with the relevant parties involved in franchise agreements as well as legislatures. The analysis was thematically conducted and accordingly supported by sufficient excerpts.

Findings: The study found several grounds to terminate the franchise agreement by the parties involved. Emphatically, the participants were unanimous regarding the breach of the contract terms and conditions as the main ground to terminate the franchise agreement.

Research limitations: The research participants were franchisors, franchisees and parliamentarians in Jordan. Additionally, the data collection constrained by funds paucity and difficulties in securing appointments with the participants who were always busy and not available. Two of the participant answered the interview questions by filling up the questions instead of face to face and recorded interview.

Practical implications: The study suggests that the termination grounds of the franchise agreement need to be more specific and limited to certain provisions which should be provided by specific act for this purpose. Otherwise the unfair termination whether by the franchisors or franchisees will continue.

Originality/value: Even though franchise agreement literatures are aplenty, this study, however, is the first attempt at qualitatively exploring in-depth regarding the termination grounds for the franchise agreement in Jordan.

Paper type: Research Paper

Keywords: franchise agreement, termination, specific act, franchise law

1. Introduction

Ever since its first introduction in the 1980s, there are now more than 150 franchise businesses operating in Jordan (Katie Withers, 2013). The franchise sector employs 12,000 people and the annual sales are at US \$100 million approximately (Katie Withers, 2013). Additionally, the local market in Jordan adopts the U.S. franchises and in this country (Jones, G, 2003), more and more interest is being expressed by the local investors towards franchise business. As reported by the International Franchise Association (IFA, 2015), interest has been shown by the local investors predominantly in the franchise industry relating to service and fast food. In fact, the past years have witnessed the exponential increase of the U.S. retail and service franchises in Jordan. Applebees, ACE Hardware, TGI Fridays are among the latest franchises in Jordan. McDonalds, KFC and Pizza Hut franchises are also found in Jordan, these businesses are based on franchise agreements that regulate the relationship between the contractual parties, which are franchisors and franchisees.

The franchise agreement comprises a contract between two parties, the franchisor and the franchisee. The franchisee is the party who obtains the right to perform a business using the framework that is pre-established by the franchisor. With this right granted by the franchisor, the franchisee can be associated with the franchisor's trademark or service. In return, the franchisor will be entitled to a certain amount of fees or monetary benefits from the franchisee (Woker, 2012). In *De Beer v Keyser (2002) 1 All SA 368 (A)*, the benefit is known as "royalty". With respect to the rights and obligations of the parties of the agreement, intention of the parties will determine which rights and obligations should ensue from the agreement, due to the reason that parties are free to set the contract terms and conditions without legal restrictions, especially with the absence of specific law to regulate this business in some nations, such as Jordan.

In the context of franchise business, formation and conclusion of the agreement are the primary key points. These two points are linked by franchise relationship, which is meant to be long-term and renewable. However,

as indicated by Emerson (2013), once both parties had signed the agreement, the lurking issue is on when and how it (agreement) may be terminated. If the agreement terminated before the term could be completed, the outcome could be catastrophic. This is particularly true when the agreement involves a substantial amount of investment on the franchisees side. It should be noted that the termination of franchise agreement refers to earlier termination, which might occur before the expiry of the contract term that have been agreed by the parties.

In most of circumstances, franchise agreements are always for certain term, usually for five years. Franchise agreements are rarely terminated by either party, during its term. Therefore, each party cannot, without ground, just terminate the agreement or else will be responsible in damages for breach of contract (British Franchise Association, 2016).

In the context of Jordan, no specific act governs the legal aspect of franchise agreements in Jordan, including termination. The franchise agreements in Jordan are governed by several acts, namely, the Civil Act (No. 43, 1976), the Trademark Act (No. 34, 1999), the Trade Name Act (No. 9, 2006), and the Unfair Competition and Trade Secret Act (No. 15, 2000).

The Civil Act governs most of the issues regarding contracts in Jordan, whether franchise or otherwise. The provisions in the Civil Act are applicable for all contracts in general. In addition, there are provisions of the Act with regard to contract termination. These provisions might be applicable to the franchise agreement as well. However, there is still an ambiguity in terms of the termination right in the franchise agreement in Jordan, especially on its grounds. This situation motivates this study to examine the grounds for the franchise agreement termination in the context of Jordan.

2. Literature Review

Research on franchise in Jordan is still in its infancy stage, because there is still no legal framework that controls the franchise sector or industry in the country. Nevertheless, since the franchise industry is now significant in Jordan, several scholars have started to explore the legal areas of the industry. However, as reported by Al Otaibi (2007), Al Bashtawai (2008), Abu Ghnaim (2010) and Al-Saealha (2011), the issues associated for termination have been disregarded.

Generally, terms or conditions which are included in every franchise agreements may be divided into two groups, namely formation and termination conditions; and operations and conduct conditions (Leblebici & Shalley, 1996). In addition, terms and conditions of contract addressing real-estate transactions are excluded, as they are the product of a different group of conditions. Therefore, they are separated from the franchise agreement. Usually, the formation and termination of franchise are enumerated to identify the rights and duties of parties and the certain contingencies.

Further, it is important for franchisors to have the ability to terminate the franchise relationship. This is because, as expressed by Kaufmann (2001), having to permanently deal with 'bad' franchisee is the worst that could happen to a franchisor. The franchisor-franchisee relationship can be terminated by the franchisor due to several grounds, these grounds including breach of contract by the franchisee, or the contract contains automatic termination ground.

2.1 Termination for Breach of Contract

The relationship can be terminated by the franchisor when there is breach of the agreement by the franchisee. Monitoring the performance of franchisee is one of primary tasks of the franchisor. If a franchisee is found to be incompetent in his or her performance, the franchisor must have the capacity to terminate the franchise agreement. Breach of the agreement may take different forms; Love (1986) elucidated the matter involving McDonald's where a Paris franchisee's contract was terminated due to non-compliance with the stipulated standards. In this particular matter, the franchisee's performance was not satisfactory. The restaurant was dirty, food was served cold as it was held too long, and the use of non-standard ingredients for the hamburgers. Aside from that, the poor performance of the Paris franchisee had caused the customers who had visited Paris to lodge complaints to other McDonald's franchisees worldwide, causing these franchisees to urge the franchisor to take action on the Paris franchisee. Then, referring the Paris franchisee as 'cancer', McDonald's president in Canada, urged for its franchise termination.

The Paris case is an example of breach of contract. That is, the franchisee did not fulfill the obligations as stipulated by the contract. In fact, obligations imposed by the contract's terms must be fulfilled accordingly, and

if not (not fulfilled at all, or fulfilled but not on time or fulfilled wrongly), then, the party responsible for the fulfillment of terms and conditions has committed a breach of contract (Christie, 2011).

Subject to the nature of the breach committed, the innocent party has numerous options (Kerr, 1998; Christie, 2011). It should be noted that despite the termination ground in the contract, the contract itself does not automatically become null and void until the innocent party agrees to the termination (Woker, 2009). Based on the judgment in the case of *Oatorian Properties (Pty) Ltd v Maroun 1973 (3) SA 779 (A)*, the contract may include a ground that enables the innocent party to have the contract terminated following any term breached. In other words, even trivial breaches would entitle the innocent party to the termination of the contract. Meanwhile, the court that handled the case of *Singh v McCarthy Retail Ltd t/a McIntosh Motors [2000] ZASCA 129; 2000 (4) SA 795 (SCA)*, which expressed that the innocent party can terminate the contract only if the breach is severe enough to call for termination. Therefore, grounds that allows for termination in the event of breach of the terms and conditions of the agreement are common in franchise agreements. Thus, it should be comprehensive to serve the best interests of the entire franchise system and other franchisees.

Contract termination is possible when there is challenge against the franchised intellectual property's proprietorship (Thomas, Pitegoff & Garner, 2008). Further, non-compliance with the demands of franchisor can lead to grave consequences. This is illustrated in the case of *Unilever SA Ice Cream (Pty) Ltd v Jepson [2007]3 All SA 294(C)*. In this case, Jepson did not comply with the demand of the franchisor to sell a competitor's product. Following this non-compliance, the franchise agreement was terminated and damages were claimed by the franchisor.

Based on the discussion above, breach of the terms and conditions in the franchise agreement is taking several forms. However, all these forms might be under one termination ground, which is breach of the contract terms and conditions. Thus, breach of the contract terms and conditions is considers among the main grounds to terminate the franchise agreement.

2.2 Automatic Termination

Franchisors can have the contract terminated provided that there are automatic grounds on termination and there is compliance to these grounds. The case of *Emile StateInc v Commodore Machines Limited (1988) 19 CCEL xxix (Ont.CA)* illustrates this matter. This case is about the franchisor's right to terminate the agreement automatically without cause. As stipulated by the contract, the relationship could be terminated by any of the parties on thirty days' notice, without any reason. According to the Appeal Court that handled the case, the ground for termination was clear and there was also no ambiguity. As such, no reasons were needed for the franchisor to justify termination of the relationship and no additional reasonable notice was required to be provided by the franchisor.

However, Woker (2009) had a differing view. The author argued that although the automatic ground that grants termination rights based on notice to both parties seems fair, it seems pointless to the franchisees in most situations. Such ground tends to benefit the franchisors only. It is because contract termination will put the franchisee on the losing side because of the investments that they (the franchisees) have made. In other words, when the franchisors terminate the contract, the franchisees could lose everything they have invested in the business.

Terminating a flourishing business automatically for no reason, which causes loss of assets on the franchisee side is unfair. In the case of *Tamarillo (Pty) Ltd v B N Aitken (Pty) Ltd 1982 (1)*, the agreement stipulated that the termination or cancellation of the franchise agreement "for any reason whatsoever" would cause all the sub-lease agreements ratified between the franchisor and franchisee to be terminated automatically and the premises would revert to the franchisor. Therefore, following the contract termination, the franchisee may lose the right to use the trademarks of the franchisor and the ability to maintain operation from those premises under franchisor trade name as well.

It is unfair for franchisors not to recompense franchisees for goodwill after the automatic termination. Another franchisee can be appointed by the franchisor at the same premises and all goodwill appointed by the franchisee would become the franchisor's or the new franchisee's property. In the case of *Tamarillo (Pty) Ltd*, the court discovered that the clauses were formulated to safeguard the goodwill of the business. However, nothing was mention was regarding the contribution, which the franchisee had made to develop that goodwill.

It is possible that franchisor who automatically terminate the franchise agreement have opportunistic behavior (Stan worth et al., 1999), a franchisor is capable to accord high levels of discretion to himself and high risk to a

franchisee by the standard form of contract. In this case, the contract facilitates franchisor opportunism (Spencer, 2010). In certain situations, franchising is established by a franchisor to "test the market." In fact, a number of theorists have suggested that franchising is not a true stand-alone business model, but rather, it is a temporary stage in business development, whereby the franchisors are ultimately willing to own all branches since it can expand their profits and control. Franchising is used to establish the business, but as soon as the cheap capital is no more required and business expansion has been achieved, at least the franchisor will buyout the more profitable franchisees (Londhe, 2006).

3. Methods

The most widely used method to collect data within qualitative research is the interview method (Holloway & Fulbrook, 2001). In qualitative methods, the researchers conducted in-depth interviews. The interviews were conducted in Jordan. Eleven respondents were interviewed, comprising four franchisors, four franchisees and three parliamentarians. The interviews were conducted from December 2014 to March, 2015. The interviews duration ranged between 50 to 90 minutes. The interviewer also used IC recorder to record and at the same time the interviewer jotted some key points for cross-checking purposes.

On the other hand, secondary sources in legal research are described as documents that interpret primary sources (Yaqin, 2007). These encapsulate legal writing (books, journals encyclopedias, digests of cases, local/international documents, official statistics, government/international bodies reports) along with other sources found in the library (Yaqin, 2007). The aim behind these secondary sources is to explain how things are often done locally and internationally. They are invaluable in learning the fundamental application of law and in conducting a comparison among different jurisdictions handling of the same issue (Mersky and Dunn, 2002). It is to be noted that, since secondary sources only elaborate what legal scholars say about a legal principle, they are therefore only considered as persuasive arguments. In this research, the secondary sources that the researchers referring are the legal writing in books, journals, encyclopedias, digests of cases, indexes, official statistics, local or international documents, and reports of governments or international bodies.

All the data, which have been obtained are analysed by using thematic and descriptive analysis methods. Legal research, for sure serves numerous objectives, the common and beneficial purposes are explanation, exploration as well as a description (Ramsay, 2006). The analytical descriptive method will allow the researcher to systematically and scientifically explain, define, examine, determine and even provide conclusions for example from the point of problems, research questions, current situations and several reasonable solutions (Ramsay, 2006). All the data will as much as possible strengthen each other. This will also prevent misinterpretation of the data or data that is unconnected between one another.

4. Results

In relation to contract termination, two different groups of items were asked to the respondents. First, four items asked to the franchisors and the franchisee, i.e. on what basis parties can terminate the agreement; is there any clause regarding grounds to terminate the franchise agreement before expiration of term; whether parties in the agreement should have the right to terminate the contract in case the other party misrepresent or give false information; and if the franchisee should have the right to negotiate with the franchisor to remedy the defect first before he terminates the contract.

Second, four items were asked to the parliamentarians, i.e. on what basis the parties can terminate the agreement; what are the grounds that should be for the parties to terminate the contract; whether parties in franchise agreement should have the right to terminate the contract in case one of them misrepresent or provide false information to the other; and whether the franchisee should have the right to negotiate with the franchisor to remedy the defect first before the franchisor terminates the contract.

Contract is a way to enter into a contractual relationship, so both parties get what they want by setting terms and conditions in such contract to achieve their goals. Sometimes, contracts can be broken because parties do not meet certain legal requirements or other legitimate reason, such as the other party does not fulfil what he promised to do in the contract. In addition, a party's right to terminate the contract for a cause can be based on a number of grounds. Majority of the respondents observed that the main ground to terminate the contract is breach of the contract terms and conditions. According to respondent 4, contract can be terminated, "if the franchisor breached the contract terms and conditions." Or as respondent 5 observed the following:

"Expired date (end the contract term), and if the franchisee breached any of the terms and conditions in the

agreement and the death (one of the parties dead)."

Also respondent 6 added the following:

"Yes, breach the contract terms and conditions, committed any action can harm the business, and if a franchisee did not fulfil any of his duties...plus others."

And also respondent 7 commented as follows:

"Actually, contract termination is an important matter. I can terminate the contract if the contract expired (contract term ended), and in case the franchisee breached any of the contract terms and conditions."

Thus, contract can be terminated if there is breach of the contract terms and conditions, end of the contract term, breach the confidentiality duty from franchisee, and noncompliance with the minimum performance level by franchisee, as respondent 8 stressed the following:

"Initially, of course breach of contract terms and conditions, breach the confidentiality duty, noncompliance with the minimum performance level or let say didn't achieve the profit target and harm my business by anyway, such as change my products quality."

In addition, contract termination can be performed by a franchisor or franchisee depending on the party who breached the contract's terms and conditions, or performed any action which allows the other party to terminate the contract. Respondent 4 mentioned the following:

"I can terminate if something wrong happened like the franchisor breaches the contract's terms and conditions."

Similarly, respondent 6 added,

"I can terminate if the franchisee breaches any of the contract's terms and conditions that can affect the business badly."

In another development, parties set the grounds for termination in the contract. Most of the grounds are also breach of the contract's terms and conditions. A question were asked to the respondents whether there are clauses regarding contract termination, and respondent 5 stressed the following:

"Yes, we have, when a franchisee breaches any of the contract's terms and conditions and the death as well, of course we can't continue the contractual relation if one of us dead."

In the same context, respondent 9 added,

"Based on the contract terms and conditions plus the grounds they agreed upon."

Trust is needed from both parties in order to achieve the aims and objectives of the contract. All the respondents admitted that they should have the right to terminate the contract in case the other party misrepresents or provides fake information. Respondent 5 stated the following:

"Yes, of course, our relation is depend on the trust and if he give untrue information I have to terminate the contract because this can effect on the business success."

In addition, misrepresentation affects the relations between the franchisee and franchisor and destroys the business then leading to termination of the contract, as respondent 6 viewed it:

"Yes, sure, misrepresent by giving false information can destroy the business."

More important, respondent 9 added,

"Yes, should have this right in case one of them gave wrong and untrue information."

Moreover, untrue information from both of parties or one of them is important reason for business failure. Respondent 11 observed,

"Misrepresent information can effect on the business success and it shows the bad intention from the party who provided these false information, so, should terminate the contract in this situation."

In another development, the interviewer asked the franchisor and franchisee whether they give right to each other to resolve the breach first before terminating the contract. Majority of the respondents admitted that it is franchisee's right to try and resolve the breach first before the franchisor terminates the contract. This is because a franchise is a commercial relation, which aims for profits and the parties have to be quite flexible with each other for business success. Respondent 4 stated the following:

"The business aims for profits, if we are going to terminate the contract for any breach of the contract terms and conditions then we will not achieve our goal. Our relation must be on give and take bases which means we

should be flexible, so I think we should have this right."

Moreover, resolve the breach should be limited to certain period of time and a franchisee must resolve the breach during this period or else the contract will be terminated, as respondent 7 stressed the following:

"First point, in my opinion should have certain period given to the franchisee before terminating the contract to try and resolve any breach of contract terms, and second point I think should not terminate the contract without litigation or negotiation. Maybe litigation can reach the suitable compromise for us."

Similarly, a franchisee's right to resolve the breach before terminates the contract by a franchisor can enhance the relation between both of them and promote the trust principle which are essential in business. Respondent 10 observed that "to keep the respect and the continues between them."

However, a franchisee's right to resolve the breach before a franchisor terminates the contract should be determined based on type of breach. This is because some of the breaches are essential and it will not be worth to give one more chance to the franchisee to resolve, as respondent 9 argued the following:

"In my opinion no, this is business and the basic in the business is the trust and everything can happen in business, I think it depends on the breach itself but just end the contract without negotiation or litigation that's not fair. Yes, if he did not course essential breach, to protect both parties' interests."

In addition, respondent 6 added,

"Yes, in some situations, depending on the breach type whether it can resolved or not."

From the analysis above, it can be stated that termination of contract is the last resort, and it happens when one of the parties breach the agreement, or end of the contract term, noncompliance, bankruptcy, false information and lack of negotiation.

5. Discussion

The aim of this study is to provide assistance to the government as well as the business community in the formulation of policies and measures, in order to enhance the franchise sector in the country. In this study, the perception and experience of the parties to franchise agreements in the context of Jordan were examined. The study is equally beneficially to the franchisors and franchisees to understand their rights. Based on the interviews conducted, several grounds for franchise agreement termination in Jordan were discovered, including breach of the contract terms and conditions; expiration of the contract term; and franchisee's noncompliance with the minimum performance requirement.

Based on the views from a number of studies such as the study by Kerr (1998), Thomas, Pitegoff and Garner (2008), Woker (2009) and Christie (2011), it can be perceived that termination grounds in the franchise agreement in Jordan need to be perfected. Based on the data gathered from the participants, the franchise agreement in Jordan, with regard to termination grounds are restricted and ambiguous. Meanwhile, breach of contract terms and conditions is the major ground for franchise agreement termination.

On the franchisor's side, breach of contract may be in the form of refusal to recognize the existence of the contract, or failure in fulfilling any promise that comprises all or a portion of the agreement. Such breach of contract can be exemplified by the failure to provide facilities, equipment or goods that the contract requires, or failure to provide training and supervision. Thus, some scholars such as (Brown, 1971; Schorr, 2010; American Bar Association, 2004) have likened the relationship between the parties as being akin to a fiduciary relationship. In doing so, it creates a standard of care by the franchisors in performing the contract to meet the stringent obligations of full disclosure and fair treatment.

Amongst the grounds that frequently compel the franchisor to terminate the agreement include the failure to abide by the requirement of the franchisor on store location. franchisee's building appearance; failure to compensate the franchisor the royalties; failure to report revenue to the franchisor; failure to correct defaults following notice; franchisee's insolvency or bankruptcy; criminal conviction; and loss of obligatory licenses, leases, or signs and employee uniforms (Kaufmann, 2001; Love, 1986; Pitegoff & Garner, 2008).

This study found that the termination of franchise agreement in Jordan is limited to certain ground, which is breach the contract terms and conditions. However, this ground is unclear as there are no standards to limit the termination based on essential breaches. Therefore, parties of the franchise agreement might suffer due to the unfair termination, especially with the absence of specific legal framework to regulate franchise agreement in Jordan.

6. Further Study

In this study, the findings represent the grounds for termination of franchise agreement in Jordan. It provides a framework where parties set clauses in the franchise agreement regarding termination. Additionally, the eleven respondents involved in this research were limited to franchisors, franchisees, as well as parliamentarians of the House of Representatives in Jordan. This study is further limited because the paper focuses on the grounds of termination in the franchise agreement, due to the fact that there is no legal framework to regulate franchise agreement aspects in the country. It is suggested that future studies explore problems militating from termination of the franchise agreement in Jordan. It is also suggested that future studies may investigate quantitatively the lack of specific legal framework and the other challenges of franchise agreement in the country.

7. Conclusion

The findings gathered from the in-depth semi-structured interviews with the respondents, which comprised of franchisors, franchisees and parliamentarians on the subject of franchise agreement termination exposed the view and the experience of the respondents on a number of contract termination grounds. As indicated by the findings, breach of the contract terms and conditions is the main ground for termination of the franchise agreement in Jordan. As such, the grounds for terminating a franchise agreement seems simple yet incomplete. In addition, breach of the contract terms and conditions is very wide. Thus, there should be standards to determine on what grounds can terminate the agreement by the aggrieved party; it is because there are breaches that do not effect on the business substantially, and thus should not involve termination. Therefore, it appears that the major obstacle facing the parties involved in the franchise industry in Jordan is the lack of a detailed legal framework to govern the termination of franchise agreement. Here, both parties are at risk for becoming victims of unfair termination and this could adversely affect their business. As such, legislation may formulate a solution for this issue.

It is necessary to have a certain form of regulation on franchise terminations owing to the nature of franchise relationship structure (Byers, 1993). When the franchisee makes franchise specific investments that are non-recoverable, the franchisee would be exposed to considerable economic risk. Therefore, legislation that governs the termination of franchise contracts should be introduced in Jordan. Further, this form of legislation is not necessarily bad news for franchisors. For instance, in the context of America where state legislation governs franchisor's rights to terminate or refuse franchise renewal, there have been situations where franchisees pay more for a franchise (Byers, 1993), because early termination have more effect on the franchisee who bear the whole fees paid to the franchisor and costs to establish the business.

Findings from this study may also provide assistance to the policymakers, investors and legislatures in Jordan in their effort to plan and strategize for more efficient franchise agreement. Additionally, the research findings may be beneficial to other Arab countries and other developing nations in appreciating the multiplier effects to the lack of franchise law to include contract termination grounds.

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