THE IMPLEMENTATION OF IMPLIED TERM TO THE FRANCHISE AGREEMENT IN THAI LEGAL SYSTEM

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Abstract: Franchise businesses, whether local or international brands have received much attention from many Thai entrepreneurs. Such attention arises in the private sector and captures much of the public sector’s interest, which encourages the private sector to utilize more benefits from the franchise system. Ironically, contrary to the growing trend of franchise business, Thailand still does not have any official franchise law. Generally, people view a franchise agreement as an unfair agreement in which the franchisee usually has little to no bargaining power against the franchisor. Many countries have alleviated such a problem by initiate the concept “Implied Term,” which consider as an obstacle to the concept of the franchise business itself and its business operation. This article aims explicitly to analyze the dilemma of using the Implied Term in the context of the Good Faith principle in the disputes related to franchise agreements in Thailand. Such analysis shall construe through various comparisons with the foreign courts’ judgments. This article shall also propose efficient ways to harmoniously apply the Implied Terms into the context of the franchise agreements under Thai law. Moreover, thus, mitigate adverse effects upon the franchise business entrepreneurs in Thailand.

Keywords: Good Faith, Implied term, Franchise agreement

I. Introduction

At present, Thailand does not have an official Franchise law. Thus, the court shall construe all franchise agreements through the concept of contract law in the Civil and Commercial Code (CCC). Additionally, the court also uses the general principle of law, the Good Faith Principle, which is considered an Implied Term with the interpretation process. However, this method causing uncertainty and conflict for the franchise agreement itself since the terms and conditions of the agreements are already explicitly agreed upon by both parties. Therefore, this implication can adversely affect the system of franchise business in Thailand.

The trend for franchise business has gradually gained more attention for the past 20 years. This trend resulted from the motivation and influence from both public and private sectors to encourage equipped small and medium-sized enterprises (SMEs) to utilize franchise strategy to expand their business. Department of Business Development under the Ministry of Commerce has also enabled this by setting up several seminars to teach thousands of Thai entrepreneurs for many years. Moreover, several attempts to propose the franchise law bill but up until now still fall short. Moreover, unfortunately, in this recent years, the Office of Trade Competition Commission (OTCC) has received numerous complaints from franchisees that the franchisor has taken advantage of them with unfair franchise agreements. These complaints lead to the franchise guideline of 2019 and 2020 to regulate the franchise business and protect the franchisee.
II. Description

The unique characteristic of a franchise agreement that distinguishes it apart from the usual business agreement is the legal relations between the franchisor and franchisee. A franchisor who is an owner of the brand possesses much more experience, business expertise in the franchise business, and a higher leverage status. On the other hand, a franchisee is another party who would like to start its own business without firsthand experience by exploiting the well-known franchise brand reputation and the knowledge-sharing system from the franchisor. In short, a franchisee wants to start a business that has already been proven successful by the franchisor. So for the franchisor, when licensing out their business, the main issue for a franchise business is to maintain the brand standard. Since only one infringement might cause damage to the franchise brand's reputation, all franchisees who operate the same franchise brand shall also receive the effect. This situation is rarely happening in other types of business agreements. Thus, the franchise agreement always strictly stipulated multiple responsibilities for the franchisee to guarantee its brand standard and prevent any future mishap.

Another uniqueness of franchise agreement is the agreement term which usually covers an extended period. Furthermore, to prevent any unexpected event in the future, the franchisor typically has an Agree-to-agree-term within the franchise agreement to support unforeseeable changes in the future. This term will require all franchisees to obey in case they need to change anything beforehand. In addition, this term allows the franchise agreement to be more flexible to adjust its business model to suit any situation. Still, it also creates a loophole for the franchisor to take advantage of the franchisee.

The interpretation of a franchise agreement using an Implied Term, the Good Faith principle, to solve any unjust in the franchise agreement has been widely accepted in common law and civil law countries. However, such application of the Good Faith principle is conflicts with the franchise business system itself and may lead to limitations when operating a franchise business. This article shall be mentioning the application of the Good Faith principle in Thailand comparing to the United States. The case studies shall examine the store territory and termination clauses to suggest how to harmoniously apply the Good Faith principle to the franchise agreement, which does not obstruct the franchise system but facilitates Thailand's franchise business operation.

A. The Good Faith principle in the Thai legal system

According to Civil and Commercial Code Section 171, when interpreting the contract, one must seek the true intention of the contract rather than the literal meaning of the words or expressions. Moreover, when the true intention of the contract cannot be found, section 368 of the Civil and Commercial Code stipulated that the contract shall be interpreted according to the requirement of good faith, ordinary usage being taken into consideration. Such Good Faith principle is based on the German law principle of Treu und Glauben, which means sincerity and faith. This Good Faith principle in Thai law is considered a provision related to public order or good morals, which ones cannot agree otherwise.

The application of the Implied Term, the Good Faith principle, Thai court has been used as a tool to provide justice to parties in both when there is an explicitly express term in the contract and when there is not. There may be chances that the court judgment can conflict with the contract's express term for the latter.
The direction of the Thai court ruling can be categorized into two groups; one which interprets per the literal meaning in the contract. Another group interprets the purpose with the usage of the Good Faith principle.

The First ruling direction example is the Supreme Court Decision No.6329/2552. The court ruled that the defendant's ground for termination of the contract cannot be heard because it has not been agreed upon in the contract by both parties. In Supreme Court Decision No.53/2546, the court ruled that no contract clause allows the plaintiff to terminate the contract before the due date. For that reason, the termination of the contract by the plaintiff before the due date is illegal. This direction of court ruling affirms the right and responsibility of both parties, which has been explicitly written in the agreement, and both parties can expect what they need to do clearly.

The second ruling direction will use the Good Faith principle as a tool for interpretation. In Supreme Court Decision No.1687/2551, the court ruled that even if the contract has given the plaintiff the discretion to decide whether to terminate the agreement or not, but the plaintiff's action that chooses not to terminate the contract with the intention to collect a higher rate of interest shall be deemed as a dishonest exercise of a right. For Supreme Court Decision No.2171/2518, the court ruled that even if the settlement agreement does not clearly state the exact amount of land that the defendant agrees to sell. The interpretation for this shall be made from the true intention of the defendant, which agrees to sell only a half piece of land. The last example is Supreme Court Decision No.5674/2545. The court stipulated that the plaintiff must issue a promissory note that the bank accepts even though the purchase and sale agreement does not specify. Thus, the court ruled to conform with the regular tradition when purchasing or selling a high price of land. These usages of Implied Term demonstrate the action of the court, which is trying to create justice. Instead, this may also raise some concerns that the explicitly agreed term of the contract cannot be fully enforced and shall affect the solidarity of the agreement itself, especially in the scenario of the franchise agreement.

The application of the Good Faith principle, on the one hand, helps protect the franchisee, which can be taken advantage of. However, on the other hand, this could adversely affect the franchisor's right when they were trying to adjust their business model.

Next, the author shall raise some example of the court ruling of the United States to exhibit the application of the Good Faith principle which disturb the concept and principle of the franchise business.

B. The application of the Good Faith principle in the franchise agreement in the USA

Franchise business originated in the United States and has received much attention. Therefore, the United States also has a lot of franchise agreement-related disputes. The direction of the United States court ruling can be categorized into two groups as follows;

1. The group which apply the Good Faith principle

In this group, the court applies the Good Faith principle, which can be seen in many judgments. For example, Vylene case,² the franchise agreement does not grant a franchisee a territorial exclusivity right, so a franchisor is able to open a new store a mile further away from the franchisee’s shop. The court ruled that even if the franchisee does not have any territorial exclusivity right to prohibit the franchisor from setting up a nearby shop. The action of opening a new shop with little distance between both shops shall be considered infringing upon the Implied Term that one shall conduct business fairly and impartially.³ Furthermore, the court also ruled
that the extension clause of the agreement term, which cannot be commercially executed, is also considered an unfair act. This ruling openly stated that the Implied Term prevails over and can substitute the explicit franchise agreement. In the Carvel Corp case,\(^4\) the use of the franchisor's discretion to approve the location of the franchise shop has been ruled as an unfair act without mentioning the rationale behind such discretion that there is a lack of confidence in the location's choice. This case also demonstrates another example that the Implied Term can be used to limit the discretion of a franchisor from choosing the preference shop's location, which is considered a prime factor for the success of franchise business. With such importance, the franchisor who possesses more valuable experiences should select a better location than the franchisee. Hence, the location selection usually part of the franchisor's responsibility.

Another case to note is Dunfee v. Baskin Robbins, Inc.\(^5\) The Montana Supreme Court found that the franchise relationship is inherently a business and refuses to decide that the franchisor has a fiduciary duty or not. The court stated that the franchisor should perform these implied terms, the Good Faith principle, and affirm that mere honesty is insufficient. Additionally, the court ruled further that "neither parties will do anything which will injure the right of the other parties to receive the benefit of the agreement."\(^6\) Comparing these ruling from Dunfee to the Lippo v. Mobile Oil Corp. case,\(^7\) which the court held that the implied term of the Good Faith principle could restrict the franchisor from terminating the franchise agreement even when the franchisee had breached an explicit fundamental term of the agreement. In this case, the defendant claimed that the plaintiff breached the franchise agreement by selling the misbrand gasoline under the Mobile brand and using the Mobile's equipment. Judge Richard Posner, dissenting and argue that "the duty of good faith should rest on both parties to the contract, and argued further that the court, by twisting the contract terms to help the little man who was dishonest but would hurt the little man who remains honest.\(^8\)

Some court ruling even went further to concluded that the fiduciary duty was an inherent part of the franchise relationship.\(^9\) But the Federal District Court in Picture lake Campground v. Holiday Inn.,\(^10\) held a different idea, the court ruled that the fiduciary duty in Arnott's case was, in reality, a duty of good faith and not the type of fiduciary duty found in an attorney-client relationship which required the utmost good faith and prohibited self-dealing on the part of fiduciary.

2. The group which decline the application of the Good Faith principle

This group of ruling places much value in the explicit clause of the agreement. For example, in the Massey case,\(^11\) the court judged that the explicitly written agreement should have more weight than a general legal principle even if the court saw room for applying the Good Faith principle. Therefore, applying the general legal principle, including the Good Faith principle, shall not replace the explicit agreement. For the Corensweat case,\(^12\) the court ruled that when the agreement allows parties to terminate the contract for any reason, then the franchisee cannot claim that the termination of the agreement from the franchisor is unfair with no solid reason cannot be used. Another case is the Dome Stadium Hotel\(^13\) when the agreement does not grant any territorial exclusivity to the franchisee. Hence, the franchisor has a right to operate in any territory with no limitation.

This group of court's judgments affirms the clarity of the settled franchise agreement and the parties' intention when executed the agreement. Nevertheless, solely strict to literal wording in the agreement can cause unfair treatment. For instance, to terminate a contract with or without reason can significantly affect the franchisee since all the investment shall be made from the franchisee. In addition, the franchisee can no longer use the trademark and not open the same
type of business as the franchisor due to the non-competition clause. In contrast, the franchisor does not lose in terms of any property at all.

Applying the Good Faith principle as an Implied Term in the franchise agreement can help protect the franchisee from being exploited by the franchisor. However, without a clear set of rules, this could also jeopardize the core value of a franchise business. Since much of the core values of the franchise business still need to use the franchisor's discretion, such as choosing shop locations, the adjustment of business, or even creating a new product.

As a result, applying the Good Faith principle in the context of a franchise agreement shall strike a perfect balance between providing protection to the franchisee and maintaining the management power of the franchisor, which the author shall elaborate further in the next part.

C. The rationale of the conditions in the franchise agreement

A franchise agreement has been designed to fulfill two objectives which are (1) maintain control over all franchisees to uphold the standard of the franchisor, the reputation, and the value of the trademark brand and (2) achieve the intended business goal. The franchise agreement usually has a lengthy contract term, so it is normal for a franchisor to adjust the business model to suit the current situation from time to time. Such changes shall also be imposed on all franchisees who operates the same trademark so that the essential characteristic of a franchise business will be maintained. The inconsistency of standard and protocol among all businesses of the same brand can create much confusion for the customer and jeopardize the core principle of the franchise business.

The franchisor has a responsibility to plan and adjust its business model to be consistent with the situation, and this task required much experience and expertise. The franchisee who is usually lacking in these kinds of knowledge and, for that reason, choose to enter the franchise agreement instead of starting their own business typically have a lower bargaining status than a franchisor. This uneven level of power made a franchisee have to obey what the franchisor suggests even if, in some scenarios, a franchisee may be the one who put in the recommendation. In the end, the franchisor is still the one who is a final decision-maker. On such grounds, the refutation of the franchisor's discretion by the franchisee or the application of the Good Faith principle in the form of Implied Term will disrupt the core value of the franchise business. The intervention then shall prevent the franchisor from adjusting its franchise brand as it deems suitable and consequently affects the turnover or even the expansion of the business.

The author would like to describe the business rationale behind the franchise agreement to clarify the complication and effect of the intervention of the franchisor's discretion as follows;

1. The determination of the store territory

A franchise agreement can explicitly set the franchisee store territory, such as a clause that specifically states that the franchisor shall not open any other store within 2 miles’ radius from the franchisee's shop. Alternatively, some agreements may not give any store territory privilege to a franchisee. This type of agreement means that the franchisor has an unlimited right to open a new store even if it is located close to the franchisee's shop.

The consideration for this issue is the changing environment of the territory. For example, the increasing population of the location which the franchisee's shop is unable to support the growing numbers of customer. This incident will damage the brand's popularity and image. The solution is either expanding the shop's area or adding more shops. Suppose that the franchise agreement restricts this action by stipulating a clear territory of the franchisee's shop. This can lead to lower service standards and allowing the competitor to open a shop within the same location.
The concern in allowing the franchisor to open up another shop in the nearby area will take away customers is hardly happening since the franchisor would not want to lower the income that they usually receive from the franchisee such as royalty, product, and raw material cost. Moreover, they also do not want to affect the prearranged payback plan adversely. These outcomes will create a drawback to those interested in the franchise brand, so in practice, the franchisor will give the franchisee a right of first refusal.

2. The assignment of a right
A long-term business agreement usually specified the criteria for the assignment of right. However, in the franchise agreement, such assignment right is typically prohibited unless the franchisor permits an assignment and approves a transferee. This condition will indeed affect the franchisee's right as a sole investor in the shop should have full power to assign the right to others. This restriction can be seen as an unfair limitation.

The concern for this issue is that the quality of a franchisee is an essential part that the franchisor needs to examine thoroughly to find the most suitable candidate to be a franchisee and received all business knowledge sharing and business secrets. The unfitted candidate who can access the brand's knowledge and business secrets can damage the brand's popularity. For that reason, even if the restriction of a right assignment can be seen as the limitation of the franchisee's right, it has a reasonable and solid ground for it.

3. The termination of an agreement
A franchise agreement usually prescribes numbers of responsibility for a franchisee and an Agree-to-agree-term, which will compel the franchisee to follow the unpredictable term. The breach of agreement may vary in the result, but it still can lead to the termination of an agreement. The franchisee can lose all the investment money or be restricted from operating a competing business to the franchisor for some time.

To remark that the infringement of a prescribed agreement can negatively affect the brand and other franchisees that abide by the term. Therefore, a franchise agreement needs to list all the detail and responsibility to regulate all franchisees efficiently to avoid such loss. Hence, an Agree-to-agree-term is also necessary to manage an unpredictable change in the future to sustain the business competition of changing consumer behavior.

D. The workable approach in implementing the implied term
Even if those contract terms sound reasonable from the franchise business perspective, it cannot deny the fact that it also creates a loophole for some franchisors to take advantage of the franchisee. The author agrees that applying the Good Faith principle as an Implied Term is still necessary to uphold the fair and balanced relationship between parties. However, such application shall also consider the condition of the franchise agreement to maintain the core value of the franchise business. The author suggesting the application of the Good Faith principle into three categories as follows;

1. The complete condition prior to the execution of the agreement
This type of condition is when the franchisor has predetermined all details before executing the agreement with the franchisee. If the franchisee does not agree with the condition, the only option is not to sign the agreement. However, if the agreement has been signed, both parties cannot modify or adjust the detail without prior consent from another party. Examples of this type of condition are franchise fee, royalty fee, or marketing fee.

This type of condition should not apply the Good Faith principle because the franchisee is aware of this information beforehand and can decline or accept such condition freely as it is deemed
proper. The decision to choose whether to enter into a franchise agreement solely corresponds to the freedom of contract principle. As a result, one cannot argue that a condition has been determined unfairly, and the court should strictly follow this predetermine condition.

2. **The condition which requires the discretion of a franchisor**

This condition will require the franchisor's freedom to adjust and modify the business model or business practice to achieve the established goal. This condition shall also include the Agree-to-agree-term. Examples of this kind of condition are the adjustment in the shop's opening hours to suit the market condition, the adding of new products or services, and the modification of equipment to increase the efficiency of a business.

This type of condition shall require applying the Good Faith principle, and the franchisor also needs to demonstrate the good cause for the use of discretion. The franchisor must reasonably justify the rationale why they think such a condition shall positively affect the business. For example, suppose the franchisor demand to change to the more expensive equipment but have the same efficiency level as the usual one. In that case, the franchisor should justify its reason, such as the marketing research, which shows that such a tool can support customer preference better than the previous one.

3. **The condition which the franchisor has a conflict of interest**

This type of condition that the franchisor has a conflict of interest, which can be incompatible with the franchisee's benefit. The author believes that the franchisor must have a proper business judgment rule that can genuinely clarify and compare its benefit with the franchisee's benefit. This action will show sincerity and transparency of how the franchisor conducts business in order to gain the franchisee's trust and guarantee a successful business companionship together. For example, the shop's location, whether it needs to be subleased from the franchisor or the franchisor, will get a commission fee from a landowner. Moreover, for the raw material that the franchisee needs to buy from, whether the franchisor gets a commission's fee from it or not, such conflict of interest should be reasonably justified.

With this kind of condition, the author believes that an utmost good faith principle must be applied because the franchisor should provide a professional standard of service to its franchisee as promised and trusted by the franchisee. The franchisor is considered a curator for other people's business or property, so the fiduciary duty principle, the duty of care principle, and the duty of loyalty should be maintained.

As explored earlier, the Good Faith principle is a fundamental principle in the Thai legal system, and thus, both parties should act in good faith. Furthermore, both parties should perform a higher level of good faith in the insurance contract, which required the utmost good faith principle. This principle originated in Article 17 of the Marine Insurance Act, 1906 of England, which stated that “The marine insurance contract is based upon the utmost good faith.” This principle, also known by its Latin name “uberrimae fidei,” is a minimum standard, legally obliging all parties entering a contract, mainly the financial transaction contract and insurance contract, to act honestly and not mislead or withhold vital information from other parties. The utmost good faith principle assures that the parties to the contract must act truthfully and ethically.

The Thai Civil and Commercial Code has adopted this principle into Article 865, which stated that both parties of the insurance contract need to disclose all the information in their knowledge unilaterally to other parties. Otherwise, the contract can be void or terminate. Compared with the franchisor-franchisee relationship, the author opines that the franchisor has a fiduciary duty to the franchisee, particularly when the franchisor has a conflict of interest. The franchisor should
not take advantage of the imbalance of knowledge and expertise between the franchisor and franchisee. As elaborated earlier, the franchisee could start his own business without entering into the franchise network. However, the franchisee trusts the experiences and expertise of the franchisor, so they chose to enter the franchise agreement and allowed the franchisor to lead the franchisee’s business to success as the business plan. The franchisor needs to act fairly and honestly in return to his business partner and uphold the fiduciary duty by declaring and disclosing all related information in making any discretion that might affect the franchisee’s business.

III. Conclusion

The franchisor shall have the duty to support the franchisee's business to succeed as planned. Furthermore, when it is deemed suitable, the franchisor shall use its experiences and expertise to make the business survive and flourish. This is the crucial point of the franchise business, attracting the franchisee to invest in the business. According to the condition's type, applying the Good Faith principle in various intensity levels shall be simple for all parties to understand and recognize their right and responsibility. Additionally, this will strengthen the contract stability without diminishing the franchisor's discretion when necessary to do so and encourage the growth of business franchisees in Thailand.

References

[7] 776 F.2d 706 (7th Cir. 1985)
[8] Ibid, at 726 (Posner, J. dissenting in part)