CHAPTER 1

The Elements of a Franchise Relationship

I. Introduction

*It ain’t what they call you, it’s what you answer to.*
—W.C. Fields

Call it what you like, but a franchise is a franchise if it contains the essential elements of a franchise relationship. Typically, those elements will include a trademark license, a fee paid to the licensor, and a communal interest in marketing the goods or services. Some business organizations call their business agreements something else to avoid the “hassles” of registration, disclosures, termination and nonrenewal limits, or other protections afforded a putative franchisee under various legal schemes. That plan rarely works when tested. It is quite possible that parties are beginning to understand this concept in light of the minimal cases covering this topic.

II. Essential Elements of a Franchise

In *Engineered Sales, Co. v. Endress + Hauser, Inc.*, No. 17-3456 (DSD/ECW), 2019 WL 955074 (D. Minn. Feb. 27, 2019), Engineered Sales Co. (“ESC”) and Endress + Hauser, Inc. (“E+H”) entered into an exclusive representative agreement
“Agreement”) under which E+H appointed ESC as its “independent sales representative.” At the time, E+H had been working with Control-Tec and encouraged ESC to acquire Control-Tec and take over as the E+H representative in the area. E+H was later involved in discussions between ESC and Miller Mechanical Specialties (“MMS”) in an effort to encourage those two companies to merge or for MMS to acquire ESC so that E+H could consolidate its sales representatives. ESC, MMS, and E+H entered into a non-disclosure agreement (“NDA”) so the parties could maintain confidentiality over the information exchanged during the discussions. E+H told ESC that it might terminate the Agreement if ESC could not work out a deal with MMS. ESC and MMS did not agree on terms, and E+H terminated the Agreement and appointed MMS as its sales representative in ESC’s former territory. Eighteen months later, E+H’s third-highest revenue-producing principal, Mine Safety Appliances (“MSA”), replaced ESC with MMS as its sales representative.

ESC sued E+H and MMS for breach of the NDA, tortious interference, and violations of the Minnesota Franchise Act (“MFA”) and Minnesota Termination of Sales Representative Act (“MTSRA”). The parties cross-moved for summary judgment.

The court granted summary judgment to E+H and MMS on ESC’s claim for breach of the NDA because its claim was based on “pure conjecture” rather than facts. The court noted that MSA was known as a market leader before the parties signed the NDA and that the exchanged information was already in the public domain and, accordingly, not covered by the NDA. For the same reason, the court granted summary judgement as to ESC’s tortious interference claim.

As to the Minnesota Franchise Act claim, the parties disputed whether ESC was an E+H franchisee, such that it could be terminated only for good cause under the MFA. The court noted that to prove a franchise relationship under the MFA, a plaintiff must prove (1) a right granted in the franchisee to engage in the business of offering or distributing goods using the franchisor’s trade name, trademark, advertising, or other commercial symbol; (2) a community of interest in the marketing of goods or services between the franchisee and franchisor; and (3) the franchisee’s
payment, directly or indirectly, of a franchise fee. E+H challenged ESC’s proof on the second and third elements.

As to the second element, the court held that ESC had established a community of interest because the statute merely requires a common interest in the marketing of goods and services and does not require the franchisee to operate under the franchisor’s name. As to the third element, there was no dispute that ESC had not paid a direct franchise fee to E+H, but ESC argued that its acquisition of Control-Tec at E+H’s encouragement was an indirect franchise payment. The court disagreed, reasoning that ESC paid Control-Tec to acquire its assets in an agreement separate and distinct from its agreement with E+H. E+H was not involved in the negotiations, was not a party to the agreement, and received no fee, directly or indirectly, from the transaction. The court further noted that the Agreement established that the parties did not intend to have a franchisee-franchisor relationship by identifying ESC as an “independent sales representative” and “independent contractor” and by providing that either party could terminate the Agreement for any reason with thirty days’ written notice, by contrast to the MFA’s provisions regarding termination.

ESC also argued that E+H violated the MTSRA by terminating the Agreement without cause and with only thirty-days’ notice. E+H argued that the MTRS did not apply because the Agreement expressly stated that Indiana law governed the Agreement. But, in 2014, the Minnesota legislature amended the MTSRA to prohibit choice-of-law provisions providing for the application of the laws of other states. The amendment became effective August 1, 2014 as to “sales representative agreements entered into, renewed or amended on or after that date.” Although the parties agreed there were no amendments on or after August 1, 2014, ESC argued the Agreement was “renewed” because ESC solicited orders on E+H’s behalf after that date. The court disagreed, rejecting ESC’s attempt to use the definition of “renewed” from a 1991 amendment to the MTRS to interpret the 2014 amendment. Looking to the plain meaning of “renew” as used in the 2014 amendment, the court found the Agreement could not be “renewed” because it did not contain an expiration date. Thus, the court held that the 2014 amendment did not apply, and
the Indiana choice-of-law provision was enforceable, thus defeating ESC’s MTRSA claim. For the same reason, the court granted summary judgment to E+H on ESC’s unpaid-commissions claim, which was premised on application of the MTRSA.

Major Brands, Inc. was a licensed wholesaler of Jägermeister’s range of products in the state of Missouri for many years, under an agreement which allowed Jägermeister to terminate only for good cause. Jägermeister sought to terminate the agreement, not for any failure of performance on Major Brands’s part, but because it was consolidating nationally with Southern Glazer’s (“Southern”). Major Brands brought suit against Jägermeister and Southern, alleging a wide variety of claims under Missouri law; the defendants filed a motion to dismiss. In *Major Brands, Inc. v. Mast-Jägermeister US, Inc.*, No. 4:18CV423 HEA, 2019 WL 1130294 (E.D. Mo. Mar. 12, 2019), the court considered the motions to dismiss.

The court began with Major Brands’s first two counts, one seeking a declaratory judgment that Jägermeister had no right to terminate the agreement under Missouri Franchise law and the other alleging a violation of the Missouri Merchandising Practices Act for such termination. The threshold issue in both claims was whether the relationship between the parties was a franchise for the purposes of Missouri law. The statutory definition of franchise expressly included liquor wholesalers in an amended portion which had specific language related to liquor wholesalers. The parties disputed whether only the specific definition needed to be satisfied to establish a franchise relationship, or whether both the specific and the general definition—unchanged by the amendment adding the specific language—needed to be satisfied. Major Brands’s pleadings would satisfy the requirements under the specific definition, but not the general definition. The court held that a plain reading of the statute as a whole makes clear that the general definition of franchise would apply to relationships within the liquor industry the same as it applies elsewhere, indicating that the specific definition only illustrates a type of relationship that
could be covered under the statute, provided it also met the general requirements. Because Major Brands had not pleaded sufficient facts to show its relationship with Jägermeister satisfied the general definition of a franchise, the court dismissed the first two counts.

Major Brands also attempted to state claims for breach of contract and the covenant of good faith and fair dealing. Jägermeister argued that there could be no such claims because the alleged oral agreement was for the sale of goods exceeding $500, and thus must have been written under the Statute of Frauds. The court disagreed, finding that the oral agreement’s dominant purpose concerned a distributorship, not the goods themselves, and thus did not fall under the Statute of Frauds. Jägermeister then argued that the alleged oral contract was for an indefinite period of time and thus terminable at will. In response, Major Brands argued that the distribution agreement only permits termination for good cause, but the court found the allegations as set forth in the complaint ambiguous as to whether the requirement to only terminate for good cause is in the contract—and therefore sufficient to support a breach of contract claim—or if the requirement only arises out of Missouri’s Franchise law. In the absence of clarity from Major Brands on this issue, the court dismissed both the breach of contract and breach of the covenant of good faith and fair dealing claims.

Next, the court found that, under Missouri law, the termination of an at-will agreement may give rise to a recoupment claim. Major Brands had pleaded that it spent considerable time and resources in developing Jägermeister’s brand in good faith, which the court found sufficient to support a recoupment claim and thus denied the motion to dismiss that claim. Similarly, the court found Major Brands had pleaded sufficient facts for its unjust enrichment claim, emphasizing that the company could plead breach of contract and unjust enrichment in the alternative.

The court then considered the plaintiff’s tortious interference claim, which it quickly dispatched because Major Brands’s pleadings were silent as to the valid business expectancy in the distribution of Jägermeister’s brand, a required element of a tortious interference claim under Missouri law. The court
dismissed the plaintiff’s claim for civil conspiracy, as it was based on the now-dismissed tortious interference claim.

Major Brands had also sued Jägermeister’s holding company, Mast-Jägermeister US Holding, Inc. (“Holding”), which filed a motion to dismiss for lack of personal jurisdiction. The court determined it could not exercise personal jurisdiction over Holding because Major Brands had not demonstrated any link between Holding and Missouri, and further because exercising such jurisdiction would violate due process.


First Priority Emergency Vehicles, Inc. (“First Priority”) entered into a Dealer Agreement with Road Rescue Emergency Vehicles (“Road Rescue”), which is one of the business names under which REV Ambulance Group Orlando, Inc. (“REV”) did business, among others. The Dealer Agreement granted First Priority the right to sell Road Rescue–branded products in New Jersey. REV eventually terminated its business relationship with First Priority, claiming First Priority failed to perform under the parties’ Dealer Agreement by failing to meet sales objectives. First Priority thereafter filed suit against REV asserting causes of action for violations of the New Jersey Fair Practices Act (“NJFPA”), breach of contract and of the implied covenant of good faith and fair dealing, and violations of state and federal antitrust law.

The court dismissed First Priority’s NJFPA claim without prejudice, finding the protections of the NJFPA did not apply. According to the court, a franchise under the NJFPA requires the franchisor’s grant of a license to the franchisee and a community of interest between the parties in the relevant market, but not every grant of permission to use a trademark in the sale of goods or services is a license within the meaning of the NJFPA. First Priority argued its allegations were sufficient to create a reasonable belief on the part of the consuming public that there
was a connection between the trade name licensor and licensee, but the court found none of First Priority’s allegations implied a proprietary interest in REV’s trademarks sufficient to determine it held a license pursuant to the NJFPA. The court noted First Priority did not operate under any of REV’s trademark names and did not allege an exclusive relationship with REV. Instead, First Priority merely sold and advertised certain REV products and, as such, the court found its relationship was insufficient to create a franchisor-franchisee license agreement.

See Chapter 4, Section II.A and Chapter 6, Section II for the court’s discussion of First Priority’s other claims.

In *Best Western International Inc. v. Twin City Lodging LLC*, No. CV-18-03374-PHX-SPL, 2019 WL 3430174 (D. Ariz. June 30, 2019), Best Western International, Inc. (“Best Western”) moved to dismiss Twin City Lodging LLC’s (“Twin City Lodging”) counterclaims, arguing it was not subject to the Minnesota Franchise Act (“MFA”) because it was a “nonprofit marketing cooperative,” not a franchisor. The court denied the motion to dismiss, finding Twin City Lodging alleged the three elements of a franchise under the MFA: (1) a license to use Best Western’s trademarks in the Membership Agreement; (2) a community of interest in which Twin City Lodging made investments to maintain Best Western membership, cooperated and coordinated with Best Western, and had a shared interest with Best Western in a successful hotel; and (3) a franchisee fee by which Twin City Lodging paid an “Entrance Fee” and “Annual Dues.” This case is discussed in more detail in Chapter 4, Sections II.A, II.B, and II.F.

The court held no franchise relationship existed under California or Washington law in *PW Stoelting, LLC v. Levine*, No. 16-C-381, 2018 WL 6603874 (E.D. Wisc. Dec. 17, 2018). Plaintiff PW Stoelting, LLC (“PW Stoelting”), a manufacturer of food service and cleaning equipment, entered into separate distributorship agreements with Defendants Prism Marketing
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Corporation ("Prism") and Advanced Frozen Treat Technology, Inc. ("AFFT"). The parties’ business relationship eventually soured and PW Stoelting sent a letter purporting to terminate the distributor agreements.

The parties disputed the effective date of the termination, but the court found PW Stoelting’s notice sufficient to terminate the agreements because it substantially complied with the termination provisions set forth in the agreements.

Defendants also disputed the effectiveness of the termination, arguing the agreements were subject to California and Washington franchise law by virtue of the fact that they were required to pay a franchise fee to PW Stoelting. The court disagreed. It held that AFFT was not a franchisee under California law because it was not required to purchase more than a reasonable quantity of goods at wholesale prices and because the required inventory level could not be deemed to constitute a franchise fee under California law. The court likewise held that Prism was not a franchisee under Washington law because its required inventory purchase could not be deemed a franchise fee because it was not an unrecoverable investment in the franchisor. Further, the court held that the purchase of inventory was not for the right to enter into the distribution agreement, but rather to ensure Prism had inventory to sell customers such that it could not constitute a franchise fee under Washington law. Because the distributor agreements were not subject to California or Washington franchise law, the court held PW Stoelting was free to terminate the agreements without cause.

The court’s discussion of the trademark claims is covered in more detail in Chapter 5, Section II and discussion of the effect of a party’s change of control during litigation is included in Chapter 8, Section XIII.

III. Essential Elements of a Dealership

A liquor importer brought a declaratory judgment action against the liquor distributor with which it had a primary relationship because the importer wanted to switch distributors. The distributor claimed that any termination of its relationship would violate the Wisconsin Fair Dealership Law ("WFDL"); the importer
disagreed that the WFDL applied to their business relationship as importer and distributor. Due to the procedural concerns raised by the parties, the court does not address whether the business relationship is that of a dealership and subject to the WFDL. Instead, the distributor Saratoga Liquor Co., Inc. (‘‘Saratoga’’) moved to dismiss the importer Pernod Ricard USA, LLC’s (‘‘Pernod’’) federal court action because the parties are bound by a 2006 state-court settlement agreement from a prior lawsuit and because Saratoga already filed suit against Pernod and the new, preferred distributor, Badger Liquor Co. (‘‘Badger’’), in Wisconsin state court.

The court, in *Pernod Ricard USA, LLC v. Saratoga Liquor Co., Inc.*, No. 18-cv-840-JDP, 2019 WL 2189214 (W.D. Wis. May 21, 2019), decided to decline jurisdiction of the dispute under the Declaratory Judgment Act. The court did confirm that it would treat Saratoga’s motion as one to dismiss based on lack of subject matter jurisdiction under Rule 12(b)(1) of the Federal Rules of Civil Procedure, instead of Rule 12(b)(6). The distinction allowed the court to consider evidence outside the pleadings, and Pernod Ricard did not object.

Under Seventh Circuit precedent, abstention is proper when a plaintiff seeks solely declaratory relief on an issue of state law, and a parallel state proceeding on the same issue is ongoing. Here, Pernod Ricard sought a declaratory judgment regarding the applicability of Wisconsin state law, but Saratoga already had filed a state court claim against Pernod Ricard and Badger. The pending state suit similarly asked the court to decide whether the WFDL barred Pernod Ricard from terminating its business relationship with Saratoga; however, the state court suit also sought to enforce the existing settlement agreement among Saratoga, Pernod Ricard, and Badger. Although Pernod Ricard filed first by several days, the court noted that the first to file is not dispositive in this situation when the later-filed action seeks affirmative relief—i.e., the injunction regarding the settlement agreement—and not merely a declaratory judgment.

The court also acknowledged that it appeared Pernod Ricard had only filed first in a strategic attempt to beat Saratoga to the courthouse. Saratoga had drafted a complaint and sought acceptance of service. Instead of accepting service, Pernod Ricard
bought itself some time by promising Saratoga to continue to sell its imported liquors to Saratoga; meanwhile, Pernod Ricard drafted and then filed its own complaint. In light of these facts and the court’s ability to exercise its discretion to decline jurisdiction under the Declaratory Judgment Act, the court declined the case and dismissed it in favor of the state court suit.

IV. Accidental Franchises

The authors’ review of cases decided during the Reporting Period did not reveal any decisions addressing accidental franchises.