CHAPTER 1

The Elements of a Franchise Relationship

I. Introduction

It all starts here. Whether the relationship between two parties constitutes a "franchise" impacts the relationship from beginning to end. The Federal Trade Commission's Franchise Rule ("FTC Franchise Rule") and certain state's laws impose obligations on the putative franchisor to provide a franchise disclosure document ("FDD") (and registration of the franchise sale in some states) prior to entering the relationship. In addition, other state's laws modify the rights of the parties irrespective of to what they might otherwise agree via contract. But what makes an arrangement between two parties a franchise relationship? Although the definitional elements are well-known by franchise practitioners – a trademark license, payment of a fee, a "marketing plan" or "community of interest" – courts continue to wrangle with the application of those elements to specific relationships. During the Reporting Period, only a few cases addressed whether a specific contractual arrangement met the definition of a "franchise." The principal case, *Louis DeGidio, Inc. v. Industrial Combustion, LLC*, explored whether certain amounts the putative franchisee paid constituted a "franchise fee."

II. Essential Elements of a Franchise

Major Brands, Inc. v. Mast-Jägermeister US, Inc., No. 4:18CV423 HEA, 2019 WL 6050731 (E.D. Mo. Nov. 15, 2019). After several decades of

partnership, alcohol manufacturer, Mast-Jägermeister US, Inc. ("Jägermeister"), notified its exclusive wholesale distributor in Missouri, Major Brands, Inc. ("Major Brands"), that it was terminating the parties' oral distribution agreement, ostensibly to consolidate its national distribution chain with a different distribution partner. Major Brands sued Jägermeister, seeking a declaratory judgement that, under the Missouri franchise relationship statute, Jägermeister could not terminate the oral distribution agreement without good cause. Major Brands also sued Jägermeister for breach of the distribution agreement, unjust enrichment, and tortious interference. Jägermeister filed a motion to dismiss all claims.

With respect to Major Brands' claim for declaratory judgment, the court denied Jägermeister's motion, finding that Major Brands had alleged sufficient facts to establish that the relationship was a "franchise" under the Missouri relationship statute: (1) Major Brands had the right to use Jägermeister's trademarks; and (2) the parties had a "community of interest" arising from the distribution agreement. The court concluded that Major Brands' assertions that it had the right to use Jägermeister's secure trademark library and that it had made investments to train and hire employees with knowledge of Jägermeister's products to maximize Jägermeister's sales in the region sufficiently alleged a "community of interest."

The court also denied Jägermeister's motion to dismiss Major Brands' contract claims because the complaint alleged specific details regarding: (1) the existence of a valid distribution agreement, despite the oral nature of the contract; (2) the parties' rights and obligation under that agreement and the mode of terminating it; and (3) breach of contract and consequential damages. The court disregarded Jägermeister's statute of frauds defense because it was beyond the scope of the court's inquiry at the motion to dismiss stage. The court further noted that, under Missouri law, a duty of good faith and fair dealing is implied in every contract and Jägermeister's argument regarding Major Brands' failure to specifically allege a breach of that duty lacked merit in the light of existence of a presumably valid contract. The court also denied Jägermeister's motion to dismiss Major Brand's claims of unjust enrichment because Major Brands claimed that it had in good faith incurred substantial expenses to market Jägermeister's products without having a sufficient opportunity to derive benefits from its expenses.

With respect to Major Brands' claims of tortious interference with its relationships with liquor retailers in Missouri, the court held that the complaint sufficiently alleged: (1) the existence of business relationships between Major Brands and other liquor retailers in Missouri; (2) Jägermeister's awareness of those relationships; (3) Jägermeister's intentional

interference with those relationships through termination of the distribution agreement without cause; and (4) damages to Major Brands.

Louis DeGidio, Inc. v. Industrial Combustion, LLC, No. 19-2690 (JRT/ECW), 2019 WL 6894437 (D. Minn. Dec. 18, 2019). Louis DeGidio, Inc. ("DeGidio") was a long-time industrial equipment distributor for Industrial Combustion, LLC ("IC"). When IC sent DeGidio a termination notice, DeGidio sued, claiming among other things, a violation of the Minnesota Franchise Act ("MFA") and seeking a preliminary injunction to enjoin IC from terminating the distribution agreement.

In evaluating the motion for preliminary injunction, the court held that DeGidio was unlikely to succeed on the merits of its MFA claims because its relationship with IC did not constitute a "franchise" under the MFA. The court found that DeGidio had not paid IC a "franchise fee," a required element of a "franchise" under the MFA. DeGidio argued that a "minimum purchase requirement" could be a franchise fee under the MFA if a distributor was required to purchase inventory that it would not otherwise have purchased, and that the minimum stock of IC products that the distribution agreement required it to maintain was such a requirement. The court disagreed, finding that DeGidio had failed to show that IC's minimum stock requirements were unreasonable and holding that the requirement did not constitute a franchise fee under the MFA.

The court also rejected DeGidio's contention that the training fees it paid IC constituted a franchise fee, finding that only mandatory fees could constitute franchise fees under the MFA and DeGidio had failed to allege that the fees it paid were for mandatory training. Lastly, DeGidio argued that certain products IC acquired from third-party suppliers and sold to DeGidio at their retail price, rather than the bona fide wholesale price, constituted an indirect franchise fee. However, the court held that, although the retail price of the products may have been passed on by IC to DeGidio, IC did not profit from these sales by further marking up that price and therefore such amounts did not constitute a franchise fee. The court then noted that, even though DeGidio was likely to experience significant financial harm from termination of the distributorship, such harm could be compensated by monetary damages. Thus, the court denied DeGidio's motion for a preliminary injunction.

Trade Links, LLC v. BI-QEM SA de CV, No. 3:19-CV-00308 (KAD), 2020 WL 1335688 (D. Conn. Mar. 23, 2020). Trade Links, LLC ("Trade Links") and BI-QEM SA de CV ("BI-QEM") were parties to a sales representative agreement that appointed Trade Links as the exclusive representative to sell BI-QEM's products in the United States and Canada. After BI-QEM acquired a competitor in Massachusetts, it began soliciting direct sales from customers in the United States and withholding certain commissions from Trade Links. Trade Links sued, asserting that BI-QEM had violated Connecticut's franchise statute, Connecticut's unfair and deceptive trade practices statute, and the implied covenants of good faith and fair dealing and had tortiously interfered with Trade Links' business relationships. BI-QEM moved to dismiss for lack of personal jurisdiction and failure to state a claim.

With respect to personal jurisdiction, the court noted that Connecticut's long-arm statute applied to foreign corporations for any cause of action arising out of a contract performed in the state. BI-QEM argued that, because the sales representative agreement covered all of the U.S. and Canada, it should not constitute a contract to be performed specifically in Connecticut. The court disagreed, noting that the sales representative agreement expressly required Trade Links to develop business and promote BI-QEM products in the entire territory. The sales representative agreement also: (1) identified Trade Links as a Connecticut entity that was headquartered in Connecticut; (2) identified a list of BI-QEM's existing customers that would be serviced by Trade Links, of which two of the six were located in Connecticut; and (3) designated Connecticut law as the governing law. The court therefore found that the parties had made it clear that Trade Links was intended to perform its services in Connecticut, and finding no due process issues, denied BI-QEM's motion to dismiss for lack of personal jurisdiction.

As to the Connecticut franchise act claim, the court concluded that the business relationship between Trade Links and BI-QEM did not create a "franchise" as defined under the statute because Trade Links was not in the business of "offering or selling goods" under a prescribed marketing plan. The court noted that Trade Links did not purchase BI-QEM's products with the intent for resale, but, rather, Trade Links acted as an agent for BI-QEM in selling BI-QEM's products. Any sales that Trade Links made were forwarded to BI-QEM to be fulfilled, and BI-QEM had the exclusive right to set the price and terms for the sale of its products, upon which Trade Links was provided a commission. Additionally, BI-QEM was required to defend and indemnify Trade Links from any liability arising from BI-QEM's intellectual property and products. Accordingly, the court granted BI-QEM's motion to dismiss Trade Links' Connecticut franchise law claims.

As to Trade Links' remaining claims, the court held that Trade Links had plausibly alleged that BI-QEM had made concerted efforts to marginalize Trade Links from its business arrangements, used threats of termination to bolster its negotiating power, filed false affidavits with the courts, and knowingly withheld commission payments. Accordingly, the court denied BI-QEM's motion to dismiss those claims.

III. Essential Elements of a Dealership

A&B Distributing, Inc. v. Heggie's Pizza, LLC, No. 18-cv-938-WMC, 2019 WL 6118718 (W.D. Wis. Nov. 18, 2019). The court determined that the Wisconsin relationship statute applied to a pizza dealership, where: (1) the parties had an oral agreement outlining the essential terms of a dealership; (2) the parties shared a continuing financial interest; and (3) the termination of the alleged dealership would have a significant adverse effect on the dealer, who derived 99% of its revenue from the dealership and worked full time in the enterprise. This case is discussed in Chapter 4.II.F.

IV. Accidental Franchises

United Studios of Self Defense, Inc. v. Rinehart, No. SA CV 18-1048-DOC (DFMx), 2019 WL 6524705 (C.D. Cal. Dec. 4, 2019). The court held that the "license agreement" granting a martial arts studio the right to offer proprietary classes created a franchise under California law because it allowed the licensee to sell goods and services associated with the licensor's trademark, required the licensee to use a common marketing plan and to administer brown and black belt tests at the licensor's headquarters, and required the licensee to pay a monthly fee. This case is discussed in Chapter 4.II.A.

Best Choice Roofing & Home Improvement, Inc. v. Best Choice Roofing Savannah**, **LLC, 446 F. Supp. 3d 258 (M.D. Tenn. 2020). On licensees' claim that the licensor had violated the Tennessee Consumer Protection Act by selling accidental franchises to licensees without providing the disclosure required by the FTC Franchise Rule, the court ruled in favor of the licensor, holding that the claim was time-barred because it was filed over a year after the licensees entered into the agreements that the licensees contended were franchise agreements. This case is discussed in Chapter 4.II.A.