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THE DISAPPEARING FRANCHISOR

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# Table of Contents

I. Introduction .................................................................................................................. 1

II. Variations on the Problem ......................................................................................... 1

III. Warning Signs ........................................................................................................... 2

IV. Business Format Franchises ..................................................................................... 3

   A. Determining the Franchisee’s Goals ........................................................................ 3

      1. Brand Power ........................................................................................................... 3

      2. Territorial Protection .............................................................................................. 3

      3. Buying Power .......................................................................................................... 4

      4. Operational Issues ................................................................................................ 4

      5. Personality Issues .................................................................................................. 4

      6. Followers and Leaders ......................................................................................... 4

   B. Deciding on Strategy ............................................................................................... 5

   C. To Pay Royalties or Not To Pay Royalties ............................................................... 5

   D. Implementing Strategy – Trying to Save the Brand .................................................. 5

   E. Dealing With the Creditors ..................................................................................... 6

   F. What Happens in Bankruptcy Court? ..................................................................... 7

   G. The Fate of Trademarks in Bankruptcy ................................................................ 8

   H. Abandonment of Trademarks ................................................................................ 9

   I. Implementing Strategy – Creating a New Brand ...................................................... 10

   J. Implementing Strategy – Seeking to Join Other Brands or Going Independent ....... 11

   K. Planning for Crisis - Contract Provisions to Protect Franchisees ......................... 12

   L. Planning for Crisis - Contract Provisions to Protect Franchisors ............................ 12

   M. Franchisor Efforts to Take Control of the Situation .............................................. 12

V. Product-Based Franchises, Dealerships and Distributorships - Market Withdrawals, Whether Voluntary or Involuntary ........................................................................................................ 14
A. The Classic Market Withdrawal.................................................................14

B. Recent Market Withdrawal Litigation.....................................................16
   1. The End of Oldsmobile........................................................................16
   2. "Volvoization"..................................................................................19
   3. The Sterling Cessation of Manufacturing...........................................21
   4. Lessons Learned from Recent Cases..................................................23

VI. CONCLUSION..........................................................................................24
THE DISAPPEARING FRANCHISOR

I. INTRODUCTION

Most often franchise and dealership relationships end when the franchisee or dealer leaves the system for one of three reasons – a termination, non-renewal, or a sale. In these situations, the system or brand usually continues onward. Much less frequently, the franchisor or supplier will leave the franchisee or dealer. Sometimes, it is the franchisor or supplier that disappears.

What are the most common reasons for the disappearance? Even with a well-capitalized franchisor, the brand and system are often simply not successful. In other words, the concept is flawed for reasons ranging from lack of franchisee profitability to lack of public acceptance. Sometimes the brand is strong and the concept good, but the franchisor is mismanaged, undercapitalized, or past its prime. Sometimes a solvent multi-brand franchisor decides to stop operating only one of its franchising concepts, while maintaining other franchise businesses. In other words, the franchisor chooses to focus its time, energy and finances on more successful systems. There might be a merger or consolidation that causes the end of the franchise system. Other times, the franchisor continues in business, but merely limps along, sometimes failing to perform its obligations under the franchise agreement, and certainly not growing the system. Last, but not least, a franchisor might disappear, or be threatened with that prospect, based on the concerted actions of its franchisees in pursuing a “bet the company” litigation strategy.

In the world of dealershipships, a supplier frequently decides to end one of its product lines while keeping others in production or initiating new lines, sometimes desiring to go to market through different channels for the new lines. Frequently, a multi-brand supplier decides to end one of its brands, while keeping others in production and sometimes consolidating products under different trademarks. Sometimes a supplier will decide to withdraw from certain territories, concentrating its efforts in a smaller geographic area. Sometimes a supplier will decide it can attain better profitability by eliminating the distribution system entirely and going to a direct distribution system or by converting distributors and dealers to commissioned sales representatives.

This paper will explore many of these scenarios with a view towards assessing the strategic goals and practical options on both sides of the table.

II. VARIATIONS ON THE PROBLEM

It may be helpful to describe certain variations on why a brand disappears.

• Even with a solvent franchisor, the brand and system may not be successful, and the franchisor abandons further franchising efforts.

• The brand and system may be modestly successful, or successful in some geographies, but the franchisor on the whole is unable to sustain the business and abandons the franchise.

• Sometimes the franchise concept is sustainable, but the franchisor is so badly mismanaged or under capitalized that the franchisor either turns the keys over to the creditors, files for bankruptcy protection, or simply walks
away. An example here is a currently pending bankruptcy involving "Giordano's®, a popular pizza restaurant system with more than 30 locations in the Chicago area, in which the franchisor was forced into bankruptcy due to issues (presently in litigation) involving its principal shareholder and members of his family.¹

- A solvent multi-franchise franchisor may decide to close down one of its franchising systems, while maintaining the other brands.
- The franchisor is just barely in business, so little that it is not performing its covenants under the franchise agreement, not growing the system, and not paying any attention to the franchisees.
- A supplier may decide to end one of its product lines while keeping others in production or initiating new product lines.
- A multi-brand supplier may decide to end one of its brands while keeping others in production, and possibly rebranding some products.
- A supplier will withdraw completely its products from some geographic markets, while maintaining its distribution of the same products in other geographic markets.
- A supplier may sell its business to another supplier that has a preexisting distribution channel and the buyer chooses not to use the former dealers of the seller.

III. WARNING SIGNS

How can franchisees and dealers determine when it is possible that the franchisor may fail and end up disappearing? There are some essential warning signs.

- Is the franchisor engaged in frequent financial restructuring?
- Is the franchisor facing periodic changes in key vendors?
- Are there rumors in the marketplace about attempts to sell the franchisor's business or chunks of it?
- Do the franchisees see departures of key employees from the franchisor, or large numbers of employees, including senior executives?
- Are there obvious signs of unresolved succession issues or other serious reasons why a privately held company might be offered for sale?

¹ Co-author, Carmen Caruso, is litigation counsel to the owners of 32 franchised restaurants in connection with this case.
Despite the movement of the general economy, is the franchisor making demands for growth and expansion inconsistent with what is practical?

Are the franchisees being kept in the dark about system developments? Has the franchisee council been disbanded or have meetings been regularly cancelled or postponed?

Are there government investigations, or consumer advocacy (or even animal rights advocacy) pressures concerning the franchise system or the franchisor?

IV. BUSINESS FORMAT FRANCHISES

A. Determining The Franchisee's Goals

Is a franchisor's disappearance good news or bad news for its franchisees? For those of us whose main contact with franchisees arises when there is trouble, the answer to this question might appear to be obvious. An unhappy franchisee given the chance to remain in business, without paying any more royalties, may indeed view the disappearing franchisor as cause to celebrate, especially since the disappearance usually follows a long decline in the franchisor's involvement.

On closer inspection, there are several variables that are likely to impact the degree to which a franchisee perceives value in its ongoing franchise relationship, and thus the degree to which that franchisee might cheer, or might mourn, the likely loss of that relationship. At the outset, we note that different franchisees in the same system might reach different conclusions. Some of the questions that each franchisee will need to consider are:

1. Brand Power

Does the franchisee perceive that it derives value from its association with the franchisor's trademarks? If so, that franchisee might wish to explore every possible way in which it might be possible to continue to use the same trademarks. Or, that particular franchisee might wish to re-brand with a former competitor, as opposed to going it alone. Brand issues are a perfect example as to how different franchisees in the same system might come out differently on this basic question. For example, a restaurant located on a remote interstate highway intersection (which counts on the brand to pull customers off the road) might view the power of the same brand differently than the owner of a unit in a residential area who depends more on repeat clientele.

In systems that had been growing prior to the events that caused the franchisor to disappear, disparity of the brand strength in different geographic markets might also lead different franchisees in the same system to different conclusions on the importance, or lack thereof, of trying to maintain brand identity. Obviously the loyalty to a trademark will be the strongest where the mark is most strongly established. In newer markets where the franchisor only recently made headway, or in markets where the franchisor was in retreat, there is likely to be much less loyalty to the brand on the part of those franchisees. In sum, in any given case, there may or may not be a good answer to the branding issue, but at a minimum this will be a critical issue for each franchisee to consider.

2. Territorial Protection
Some franchisees (especially those that are engaged in the provision of services like home health care) derive a substantial benefit from having received a defined territory in which they are protected (to varying degrees) from intrabrand competition. That territorial protection would necessarily disappear along with the franchisor unless another vertical relationship is established. In such a system, the newly emancipated franchisees would be prohibited from entering into a horizontal agreement to divide markets. If, as is fairly common, some of the franchisees are much stronger than their neighbors, the strong might be inclined to cheer the absence of territorial limitations on where they could compete while the weaker neighbors might fear their own extinction.

3. Buying Power

For franchisees in systems that have successfully harnessed their group purchasing power, the possible loss of the franchisor might be detrimental. On this issue, the soon to be ex-franchisees might pursue the possibility of forming their own cooperative, which may or may not prove to be an achievable goal. If a new cooperative is established, it may or may not prove to be an adequate replacement for the franchise system's buying power.

4. Operational Issues

Sometimes franchisees believe that their franchisor is essentially incompetent in managing the brand and the system. That perception may or may not be justified, but it would hardly be surprising to observe a strong correlation between franchisors that are truly incompetent and those that are likely to disappear. In these situations, the franchisees are likely to cheer their franchisor's demise. This is also a prime area in which the franchisees might be working to put the franchisor out of its misery (speaking from the franchisee point of view) with the filing of a "bet the company" complaint.

5. Personality Issues

Inevitably, there will always be some personality conflicts. Some folks just should not be franchisees, often because they are simply incapable of following directions, playing on a team and following the rules. Other folks simply should not be franchisors because they are not leaders in any sense of the word, or they have become perceived as irrational tyrants. Other times, both the franchisor and franchisee might be capable of success but incapable for whatever reason of working together. This is clearly a possible factor that may influence how franchisees might feel about their franchisor's likely demise.

6. Followers and Leaders

Last but not least, the degree to which each franchisee might engage in his or own analysis of these factors may also vary. As in any grouping of individuals, some of the franchisees will be leaders to whom other franchisees look for guidance on important issues, such as how to react if the franchisor is likely to vanish. To the extent there is any movement in the direction of a collective solution, such as a franchisee attempt to buy out the franchisor, the emergence of franchisee leadership is vital. Likewise, the extent to which franchisors (or arguably paranoid franchisors) might search for reasons to terminate the perceived leaders of a franchisee rebellion is presumably familiar to most veterans of this Forum. A system in which this is occurring could well be headed for extinction – if nothing else it is usually not a sign of good system health.
In systems where there is an independent franchisee association in place, the officers (especially the founding officers if they are still around) might be the natural leaders. In other systems, if there is a franchisee advisory council, the members of that council may be perceived as leaders, or they might be perceived as puppets, by the other franchisees.

B. Deciding On Strategy

From an analysis of the above factors, the franchisees are likely to have a strong sense (both individual and collective) as to whether they perceive the franchisor’s demise as a positive opportunity, an impending disaster, or something in between. At this point, the franchisees must decide the path that they wish to pursue as to the future of their businesses. Broadly speaking, the choices are:

- The franchisees band together in an attempt to save the brand;
- The franchisees band together in an attempt to create a new brand;
- Individual or groups of franchisees seek to join other brands;
- One or more franchisees seek to go independent; or
- One or more franchisees agree that the situation is hopeless (that whatever is driving the franchisor out of business applies to them too) and they disappear as well.

Variations on these strategies abound and are discussed below with respect to implementation. In connection with their business strategy, the franchisees (either individually or collectively) may also elect to file a lawsuit seeking damages occasioned by this disturbance to the status quo and its underlying causes, or they might seek injunctive relief in an effort to tip the balance in favor of the strategic business objective they seek.

C. To Pay Royalties or Not To Pay Royalties

An early issue for the franchisees when it appears that a franchisor might disappear is whether to continue to pay royalties. Franchisees might correctly believe that they have not received value for their money, but in almost every case, the franchisees must be advised that if they intend to remain in the brand (using the franchisor’s trademark) they must pay the royalties.2 The alternative of not paying royalties is advisable only when the franchisee is prepared to face the possibility of being required to de-brand and/or litigate the issue of whether the post-termination non-compete clauses are enforceable. Clearly, the strategy of pursuing a royalty strike will almost always raise the stakes for the franchisee(s).

D. Implementing Strategy -- Trying To Save the Brand

This strategy lends itself toward making an offer to purchase the trademarks and other assets of the franchisor, and arguably toward acquiring by assignment the existing franchise

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agreements. Depending on the franchisor's status, this offer might be made to the franchisor itself, or to a receiver or in connection with a bankruptcy proceeding. In connection with this strategy, it will often make sense for the franchisees to file a lawsuit (or an adversary claim) alleging that the franchisor breached the franchise agreements in one or more ways. One obvious benefit of asserting such a claim is not merely to depress the price that the remnants of the franchise system might command. Also, filing a lawsuit that has the potential to free all current franchisees from their executory obligations under their franchise agreements (based on the doctrine of prior material breach) might also scare away competing purchasers of the franchise system, although that outcome is not certain. Another purchaser might wish to acquire the trademarks only, and would be delighted not to be saddled with any obligations to a franchisee community that is already unhappy. On the other hand, a potential purchaser might view the situation from the standpoint of converting the franchised locations into company-owned stores — and to the extent the franchisees decide to go on a royalty strike they could inadvertently play into the hands of that strategy.

In any event, franchisees seeking to pursue a buy-out strategy need to think long and hard about how the franchise system will be structured if their bid is accepted. Will one or more of the existing franchisees become the franchisor, or is the purchase being collectivized such that it makes sense to create a new entity to become the new franchisor (with the existing franchisees to become owners of the new franchisor in proportions that will have to be decided). In this type of scenario, the franchisees will have to decide whether they will remain franchisees in addition to being part owners of the franchisor, or perhaps whether their units will become company owned. If they are to remain franchisees, presumably a new franchise agreement will have to be drafted in order to avoid some of the potential conflicts that might arise in the future. For example, what happens if one of the new owners defaults on his franchise agreement and franchisor/franchisee litigation erupts involving a franchisee that also sits on the franchisor's board? As an alternative, the franchisees might consider forming a cooperative, in which each franchisee could become a member, but again the franchisees will face the fundamental questions of who is running the show and what will be their relationship to each other. All of these questions will need to be considered.

One question, however, should be very easy to decide. If one does not already exist, franchisees seeking to work together toward a common purpose, such as buying the brand, should almost certainly create an independent franchisee association, through which they can act collectively in the most efficient manner possible.

E. Dealing With the Creditors

In nearly every case, a financially unsuccessful franchisor will have a principal lender or other secured creditors who will lay claim to any valuable asset that remains if the franchisor is unsuccessful and the franchisor truly abandons the franchise. This means that the secured creditors will claim an interest in the franchisor's trademark rights, albeit subject to the rights granted in the franchise agreements to the franchisees.

But the secured creditors' rights are only rights as a creditor, and the secured creditors do not actually own the assets, as opposed to having a lien on the assets that gives the creditor priority in the event of the sale of the assets. Of course, in an overwhelmingly large number of cases, if a franchisor is of any significant size, the failure of the franchisor will result in a bankruptcy, either a restructuring under Chapter 11 or a liquidation under Chapter 7. This subject is dealt with below.
In any event, the secured creditors will be in the driver’s seat if there is no bankruptcy and the franchisees, who most often are not creditors of the franchisor, will not be free to continue to use the trademark and other assets of the system without payment of franchise fees or royalties. But creditors are not generally interested in operating the franchisor’s business, which means that their interest is in getting paid as much as the remaining assets will yield, and the franchisees, if banded together, may have enough economic wherewithal to purchase a potentially successful franchise operation from the franchisor. Alternatively, groups of franchisees or even individual franchisees may be able to negotiate licenses for the continued use of the franchise trademarks in order to maintain operations as successful franchisees, where suitable suppliers may be maintained or be replaced.

F. What Happens in Bankruptcy Court?

Unless the franchise concept is so overwhelmingly unsuccessful that there is nothing to salvage, the failure of a franchise for any one of the reasons discussed above will likely result in either a voluntary or involuntary bankruptcy. Sometimes the franchisor is merely trying to close its company-owned stores (like the Bennigan’s bankruptcy in 2008) or the entire system might be in such significant jeopardy that the franchisor is seeking to reorganize and get the fresh start promised by a Chapter 11 bankruptcy. Sometimes it is a Chapter 7 bankruptcy and the sole function is to liquidate the assets of the franchisor.

In a Chapter 11 bankruptcy, provided the franchisor can secure interim financing to keep operating, the franchisor or creditors may propose a plan of reorganization. The plan may contemplate continued operation of the business in some modified form, or a liquidating Chapter 11 plan. At a certain point in the proceedings, the debtor determines whether to accept or reject the franchise contracts which are executory contracts within the meaning of 11 U.S.C. §365. If a franchise agreement is rejected by the debtor, then there is no need to continue to pay royalties, and the key issue then becomes whether the rejected franchisee can continue to use the franchisor’s trademark. This subject is discussed in detail below.

In both Chapter 11 and Chapter 7 bankruptcies, sometimes the result is that a third party buyer takes over the franchisor’s position. If this is the subject of the Chapter 11 plan, it must be approved by creditors holding two thirds of the amount of existing debt and one half of the total number of creditors. Because the franchisees are normally not creditors of the franchisor, they will likely not have a vote – unless, by chance, the franchisor owes the franchisees monies pursuant to refunds or credits. In Chapter 7, the trustee’s obligation is to secure the largest amount of money for the benefit of the creditors of the bankruptcy estate, and therefore the franchisees will typically not have a vote on the identity of the successor, if any.

In either case, the franchisees are not always left without remedy. For example, in the Ground Round bankruptcy a group of franchisees asserted a claim against the franchisor for misappropriation of the advertising funds and made a claim for lost profits and opportunity costs as a multiple of the advertising fund. The claim, however weak or solid, was in the neighborhood of $40 million, which trumped the $8 million offer by a potential buyer of the system. The franchisee group was ultimately able to purchase the system out of bankruptcy for $4 million in cash and settlement of the claim.3 However, a word of caution is in order. The

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bankruptcy court may disqualify from bidding any party that is found to have acted in bad faith where the effect of the bad faith is to lower the fair market value of the bankrupt estate. Arguably this is not a danger if the franchisee's complaint passes muster under Bankruptcy Rule 9011. Nonetheless the subject should be vetted before any complaint is filed. Likewise, the Trustee (if one has been appointed) is likely to argue that a royalty strike can be an act of bad faith, as it may be calculated to lower the value of the estate. Alternatively, the franchisor as debtor-in-possession or the shareholders of the franchisor, if a Trustee has been appointed, may wish to make these arguments.

In the pending Giordano's bankruptcy, for example, several franchisees were alleged to have withheld royalties in order to force the company into insolvency, whereas the franchisees contended that the franchisor had abused its discretion in requiring the franchisees to buy virtually all required products from a single commissary that was an affiliate of the franchisor. The franchisees found the Trustee willing to negotiate a fair resolution of the outstanding royalties as well as improved contract terms that will apply going forward. The Trustee, motivated by a desire to sell the system at an auction to the highest bidder, has been quite candid in describing the need to settle with the franchisees as key to the success of the bankruptcy. The franchisees, therefore, find themselves in an enhanced bargaining position.

However, as this article goes to press the principal shareholder is litigating against the Trustee, the primary lending bank, and the franchisees, while a sale of the system remains on the horizon, and all key players may fairly be said to be jockeying for position. The shareholder litigation raises numerous issues, starting with the question of whether the shareholder has any claims that do not belong to the estate. Larger questions include whether the shareholder is simply trying to discourage anyone else from bidding on the system in the auction process.

Even a white knight buying the system out of bankruptcy will face substantial challenges, because the word is out about the weakness in the system, which may include inherent problems with the business or the existence of litigation among the various stakeholders. The new franchisor will have to start over in negotiating favorable supply agreements, unless there are executory contracts with suppliers that may be assumed in a Chapter 11 plan. There are always franchisee failures along the way if the process has taken a significant amount of time during which there are adverse effects on franchisees. In the Ground Round bankruptcy, the system started with 72 stores when the chain went into bankruptcy and as of 2008 only 46 restaurants remained open.4

G. The Fate of Trademarks in Bankruptcy

Before discussing how bankruptcy affects trademark rights, it is important to analyze whether there are contractual provisions in the franchise agreement that address the use of the trademark in the event of a franchisor's bankruptcy. The most vexing problem for franchisees is where the bankrupt franchisor rejects some or all of the franchise agreements, but the franchisees nevertheless wish to continue the use of the trademark. The general rule under Section §365(n) of the Bankruptcy Code is that the rejection of the franchise agreement terminates the trademark license and deprives the franchisee of the continued right to use the

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4 See http://www.businessweek.com/smallbiz/content/aug2008/sb2008084_482588.htm (last visited July 28, 2011).
trademark. It should be noted, however, that there is the possibility of requesting the bankruptcy court to use its equitable powers to permit the franchisee licensees to continue to use the marks. Note also that there may be an exception where various types of intellectual property rights are bundled together in a single license agreement or license provision in a franchise agreement, because under §365(n), trademark rights are treated differently than other intellectual property rights, which may continue to be used by the non-breaching, non-bankrupt party to the agreement.

H. Abandonment of Trademarks

If the franchisor is truly disappearing, that is to say drying up and blowing away, and there are no creditors asserting rights to the franchisor's assets, whether in bankruptcy or otherwise, it may be possible to assert that the trademark has been abandoned by the franchisor and may thus be used by franchisees in the network who wish to continue operating their business under the franchisor's trademark. In the United States, under §45 of the Lanham Act, the non-use of a trademark for a period of three years generates a presumption of abandonment. The trademark is deemed to be abandoned if either of the following occurs: (1) When its use has been discontinued with intent not to resume such use. Intent not to resume may be inferred from circumstances, and nonuse for 3 consecutive years is prima facie evidence of abandonment. "Use" of a mark means the bona fide use of a mark made in the ordinary course of trade, and not made merely to preserve a right in the mark. (2) When a course of conduct of the owner, including acts of omission as well as commission, cause the mark to become the generic name for the goods or services on or in connection with which it is used or otherwise to lose its significance as a mark. In either event, if the mark is deemed to be abandoned it becomes public. This means that if the franchisees obtain rights in the mark by abandonment, those rights are shared by others in the public and the franchisee network has no right to exclude others from the use of the mark.

The presumption created by three years of non-use is rebuttable. Here, there is a split of authority. Some courts hold that trademark rights can continue to exist only if the franchisor shows an intent to resume the use. Other courts hold that the owner of the trademark can preserve its rights if it shows any evidence of an intent not to abandon the mark.

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6 In re Exide Techs., 607 F.3d 957 (3d Cir. 2010) (Ambro concurring) in which the concurring judge indicated that while courts may use §365 to free a bankrupt trademark licensor from burdensome duties that hinder his reorganization, they should not use it to let a licensor take back trademark rights it bargained away.


8 Exxon Corp. v. Humble Exploration Co., 695 F.2d 96 (5th Cir. 1983).

If abandonment is proven, the franchisees might retain the right to keep the same name, without having to purchase that right – but at the same time, the name will surely be worth less unless the surviving franchisees can re-register the mark themselves. If the marks are not re-registered then presumably other competitors will begin using them. Re-registration by one surviving franchisee may not be possible, as there is likely to be too much prior and continuing use by all of the other franchisees. This dilemma suggests that if the desired strategy is to save the brand, a new entity should acquire the mark from the disappearing franchisor and not rely on an abandonment argument.

Franchisees may also wish to argue that they have rights in the trademark if the franchisor granted purely a "naked license." The theory is that if a trademark owner allows a licensee to use its trademark without ensuring that the licensed products meet standards that the owner believes symbolize the trademark, it loses value and therefore anyone may be able to use it. This theory is arguably fundamentally inconsistent with the concept of franchising, where most if not all franchisors will endeavor to create standards for the trademark use, which is antithetical to a showing of naked licensing.

Franchisees traditionally face the defense of "estoppel by license" whenever they try to challenge the franchisor's mark – although this defense is not always applied automatically, as "[t]he Restatement cautions that licensee estoppel is an equitable doctrine which is not to be rigidly applied in any and all situations: '[A] court remains free to consider the particular circumstances of the case, including the nature of the licensee's claim and the terms of the license." Further, the doctrine of "licensee estoppel" should not be a defense in the event of a failure by the disappearing franchisor to maintain quality standards; or after the franchise relationship is terminated.

I. Implementing Strategy -- Creating A New Brand

This option presumes that the franchisees can be excused from their obligations under their existing franchise agreements, principally their post-termination non-competition clauses, and also, the obligation not to use the trade secrets or other confidential information that had been licensed to them. If the franchisor has gone completely out of business and there is not a franchisor-designated successor seeking to acquire the franchise agreements by assignment, being excused from the franchise agreements is not likely to be a difficult hurdle. If the franchisor is attempting to assign the franchise agreements, then it will become crucial for the franchisees to prove a prior material breach (or some other violation of law) that will arguably

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10 See Barcamerica Int'l. USA Trust v. Tyfield Importers, Inc., 289 F.3d 589 (9th Cir. 2002).


12 See Id. §18:63 (citing Restatement (Third) of Unfair Competition §33 (1995)).

excuse further franchisee performance. A buy-out is also possible, of course. However, the liberated franchisees are taking some risk if they decide to use the former franchisor’s trade secrets, which may belong to an owner or even a creditor of the disappearing franchisor, unless and until the right to use those trade secrets is clearly established. There is similar risk in any decision to continue using the trade dress (pertaining to the look and feel of each unit). The assessment of whether this risk is acceptable is likely to vary with the facts of each case and must be balanced against the desire at the unit-level to keep the doors open. Attempts to rebrand and remodel may be costly and time-consuming and outside the restaurant and hotel business may be impossible. Franchisees, desiring to stay open (and who did not have the opportunity, or did not take the opportunity) to plan in advance may find themselves very tempted to take their chances on these questions and deal with the ramifications later – particularly where the franchisees have reason to believe that there may not be a plaintiff to assert a trade secrets or trade dress claim against the ex-franchisees.

Once the franchisees are successful in their escape from the failing franchisor, they then will face all of the issues discussed above in terms of creating a new system, (e.g. will there be a new franchisor that the franchisees will own).

J. Implementing Strategy -- Seeking to Join Other Brands or Going Independent.

The key to these options is obviously to be free from any post-termination restriction on competition, which should not be difficult if the franchisor is out of business, but may be more complicated if the brand has been sold to another party that seeks to enforce the franchise agreements. Here, however, it should not be that difficult for any franchisee to identify and assert some breach of contract that would arguably serve to invalidate the non-compete clause on the grounds of prior material breach. However, a claimed breach of contract by the franchisor will not automatically invalidate the non-compete clauses. The question of whether the breach is sufficiently material to render an otherwise enforceable non-compete clause unenforceable comes down to “inherent justice” of the matter; with a focus (under Illinois law) on “two interrelated issues: (1) the intent of the parties with respect to the disputed provision; and (2) the equitable factors and circumstances surrounding the breach of the provision.”

As stated, the more serious risk might be to avoid being charged with misappropriation of trade secrets (or trade dress) by a successor in interest to those rights. However, if the franchisor disappears, and the franchisees de-identify, then for the reasons discussed above the franchisees might be willing to risk the potential liability that could arise from misappropriation. Indeed, a franchisee that is particularly bold might reach the same conclusion as to the trademark itself – although it is difficult to imagine any lawyer advising that course of action without at a minimum explaining the serious risk, including the breadth of relief available to trademark owners under the Lanham Act.

14 See e.g. Francorp Inc. v. Siebert, 126 F. Supp. 2d 543, 547 (N.D. Ill. 2000), holding that whether a breach of contract (in that case, the failure of an employer to pay compensation due to the president of a consulting firm) is sufficiently material so as to excuse compliance with a post-termination non-compete clause is based on “the inherent justice” of the matter.

15 Elia Arnhold and Byzantia, L.L.C. v. Ocean Atlantic Woodland Corp., 284 F.3d 693, 700 (7th Cir. 2002) (citations omitted).
Beyond those concerns, the issues are of a business nature. To what extent did the disappearing franchisor supply anything essential to the business that cannot be replaced – or, what are the replacement costs including the cost of educating the customers? Is the new brand compatible? Will the new franchisor (or manufacturer, distributor etc.) offer some incentives for the conversion? Is there any conflict with existing outlets? What expansion opportunities might be available? As always, franchisee counsel will want to get as much protection in the initial contracts as possible.

The need to be emancipated from the disappearing franchisor obviously applies here as well. Beyond that the concerns are those of any potential new business. These concerns parallel the questions to be asked when considering the prospect of joining another brand.

K. Planning for Crisis - Contract Provisions to Protect Franchisees

While an individual franchisee’s opportunity to negotiate provisions of a franchise agreement is most often limited to non-existent, established franchisee associations may have the opportunity to negotiate additional contract provisions at the time of renewal in exchange for the types of additional concession or changes that franchisors or suppliers from time to time propose. These additional provisions could include rights in the trademarks in the event of franchisor insolvency or bankruptcy. A sample provision to be added in the franchise agreement is:

Notwithstanding the foregoing, if the franchisor files a petition in bankruptcy, whether Chapter 11 or Chapter 7, or whether an involuntary petition in bankruptcy is filed by the creditors of the franchisor, the franchisee shall have the continued right to use the Trademarks in connection with its business during the pendency of any bankruptcy proceeding, and thereafter in the event the debtor in possession of any Chapter 11 proceeding rejects this agreement as an executory contract under §365 of the Bankruptcy Code, or in a Chapter 7 proceeding where the result is the liquidation of the franchisor’s assets and no buyer elects to purchase the assets from the bankruptcy estate and continue the operation of the franchise system.

L. Planning for Crisis - Contract Provisions to Protect Franchisors

The franchisor (and its creditors) likely have mirror-image concerns about the franchisees’ right to the continued use of the trademark. To be a saleable asset in the event of reorganization, iron-clad limits on who can use the trademark and payment of royalties or franchise fees is likely critical to the ability to redeem a financially failing franchise system. Therefore, the franchise agreement, from the franchisor’s perspective, should contain a provision terminating the franchisee’s ability to use the trademarks if, for any reason, the agreement is terminated or rejected as an executory contract in bankruptcy.

M. Franchisor Efforts to Take Control Of The Situation

In an example that a Forum member has alerted us to, a proactive soon to disappear franchisor wrote a letter to each franchisee, advising the franchisees of three alternatives available to them in connection with such disappearance, as follows:
(1) Franchisees who are in good standing (including royalty payments up to date) may choose to continue to operate their Centers under the BRAND logo and using the BRAND system. You would be relieved of all your obligations under the franchise agreement, including any further royalty or marketing payments. We would provide all materials to date, including recipes, prep sheets and all associated documents created by FRANCHISOR. You would be entitled to retain all manuals. You would be entitled to use the web design so long as you make arrangements directly with WEB HOST and pay the monthly hosting fee to them. FRANCHISOR would grant you a license to use the BRAND trademark. FRANCHISOR would continue to provide operations support to you through the end of the calendar year, until LAST DAY. Documents will be provided through THE FOLLOWING MONTH only if your royalty, marketing and web fees are paid through LAST DAY.

(2) You could continue to operate your business, but become entirely independent. You could operate your business under any other name of your choice, but it cannot be "BRAND" or have "BRAND" anywhere in the name. FRANCHISOR would not provide you with any further materials or documents. You would be relieved of all your obligations under the franchise agreement, including any further royalty or marketing payments.

(3) You could choose to close your Center and not operate a business. FRANCHISOR would not provide you with any further materials or documents. You would be relieved of all your obligations under the franchise agreement, including any further royalty payments.

In all three cases, you and BRAND would enter into a mutual franchise termination agreement, ending all obligations under the franchise agreement and releasing each other from any and all claims. The effective date of the termination agreement would be LAST DAY.

Again, we regret that our business has reached this point. Feel free to contact us and we will arrange telephone call with you if desired. Thank you for your hard work, your ideas, your loyalty and your patience. We hope that we can find mutually satisfactory terms with all of you and we wish you all the best in your future endeavors.

In this instance, the franchisor was obviously hoping that as many of its franchisees as possible would be enticed by the possibility of keeping the brand name alive that they would agree to become current and pay royalties for about three additional months (from the date of the letter to the “last day”). However, this letter appears to have succeeded only in inciting some of the franchisees to file suit. The moral of the story might very well be that once it becomes obvious that the franchisor is going to disappear, few if any franchisees are going to pay any more royalties.
V. PRODUCT-BASED FRANCHISES, DEALERSHIPS AND DISTRIBUTORSHIPS - MARKET WITHDRAWALS, WHETHER VOLUNTARY OR INVOLUNTARY

Where the subject of the franchise/distribution relationship is the sale of a line of products, the disappearing franchisor/supplier creates a more fundamental problem for the distribution network. Unlike the business format franchise discussed above, the distributors and dealers of an unsuccessful supplier cannot practically continue manufacturing the franchised product. For this reason, this section will concentrate on whether or not a supplier has the right to go out of business, stop making a product line, sell a product line or withdraw from a geographic area.

A. The Classic Market Withdrawal

The classic market withdrawal is where the manufacturer permanently ceases to sell its products. The classic market withdrawal can occur either as to a limited geographic area, or the cessation of supply can occur completely. Where there is a complete market withdrawal, a supplier may go out of business. The complete market withdrawal may result in liquidation or non-operation of the supplier or the supplier may continue in some form, perhaps supplying continued parts and warranty service for continuing dealers.

Although it is difficult to harmonize all of the market withdrawal cases, there are certain essential principles that will normally apply, albeit with certain outliers. The first primary principle is that a manufacturer that seeks to terminate distribution or dealership agreements should be able to point to contractural provisions that either permit termination at will or permit the sale of a product line, the termination of manufacturing, or the withdrawal from a geographic area as proper grounds for termination of the distribution/dealer agreement. The failure to include proper termination provisions, particularly in regulated industries, has been found to create liability for wrongful termination when the supplier either sells its product line and seeks to terminate or attempts to go out of business.

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16 For a more complete discussion of the subject of market withdrawals, see "Market Withdrawal – the Landscape of "Termination by the Market" by Jon P. Christiansen and Scott E. Korzenowski, 28th Annual Forum on Franchising (2005).

17 McElroy v. B.F. Goodrich Co., 73 F.3d 722 (7th Cir. 1996).


20 Particularly in big-system market withdrawals, there are from time to time cases that evidence a degree of sympathy for dealers who have invested their life savings and energy in the product line, especially where the alleged termination occurs as a result of the sale of the product line, rather than the failure of the product line and the total cessation of manufacturing by the manufacturer.

21 Buono Sales, Inc. v. Chrysler Motors Corp., 363 F.2d 43, 49 (3d Cir. 1966); Carl Wendt Farm Equip. Co. v. Int'l Harvester Co., 331 F.2d 1112 (8th Cir. 1961); Delta Truck & Tractor, Inc. v. J.I. Case Co., 975
Although many distribution agreements include provisions authorizing the supplier to discontinue and change product lines, comparatively few include provisions that expressly authorize a supplier to terminate the agreement upon the sale of a product line cessation of manufacturing or sale of a business. Counsel representing suppliers should be careful to draft clauses with sufficient precision to anticipate a wide variety of reasons for which the manufacturer might wish to disassociate itself from the distribution channel.

A second fundamental conclusion that can be drawn from the case law is that courts are significantly more sympathetic to suppliers that withdraw from the market and terminate, sell a product line, or stop manufacturing if the supplier is acting to stem losses from the business.\textsuperscript{22}

There is an interesting interplay between state dealer regulations, which typically require good cause for termination, and the natural inclination for courts to be sympathetic to manufacturers who are incurring losses that may imperil the entire company’s operation. Certain state dealership statutes limit good cause to dealer malfeasance,\textsuperscript{23} certain other dealership statutes define “good cause” as including, but not limited to, dealer malfeasance,\textsuperscript{24} and other state dealership statutes expressly list “market withdrawal” or “product discontinuation” as “good cause,” justifying termination.\textsuperscript{25}

Drawing cogent conclusions from the case law in each of these circumstances can be difficult, but a fair conclusion is that the more serious the manufacturer’s losses, the greater the likelihood that the courts will find a way to permit the manufacturer to terminate.\textsuperscript{26} If the


\textsuperscript{24} See, e.g., N.C. Gen. Stat. §§18B-1304, 18B-1305(a) (beer franchises may not be terminated without “good cause,” defined as “when the wholesaler fails to comply with provisions of the agreement which are reasonable, material, not unconscionable”); N.C. Gen. Stat. §20-305 (6)(a)(1)-(2) (motor vehicle franchises may not be terminated absent a determination of “good cause” and “good faith” of the manufacturer and defining “good cause” to include “failure by the new motor vehicle dealer to comply with a provision of the franchise [and] ... failure of the new motor vehicle dealer to comply with reasonable performance criteria”). Likewise, both the Arkansas and Louisiana dealer-protection statutes prohibit terminations without “good cause,” and both statutes expressly limit “good cause” to dealer non-performance. Ark. Code §4-72-202(7); La. Rev. Stat. §51:482(8).

\textsuperscript{25} In light of recent developments in the motor vehicle industry, state legislatures have, in some instances, required manufacturers that withdraw from a market and thus terminate the sales and service agreement to compensate the dealer for the value of the dealer’s business. Ala. Code 8-20-5(j); §15 ILCS 710/4(h).

\textsuperscript{26} Compare Sims Wholesale Co. v. Brown-Forman Corp., 468 S.E.2d 905, 909 (Va. 1996) (manufacturer’s desire to consolidate distributors for more effective marketing was not good cause) with Satellite Receivers, Ltd. v. Household Bank, 822 F. Supp. 174 (E.D. Wis. 1996) (recognizing but not
statutory definition of "good cause" is open-ended, meaning that good cause "includes" but is not limited to a list of statutory actions by the dealer or distributor, then courts are more likely to sustain the manufacturer's position.\textsuperscript{27}

Although very few cases have addressed the issue, where courts interpret a state statute to prohibit market withdrawals by a money-losing manufacturer, unless future lost profits and other damages are paid to dealers, some courts have questioned whether an interpretation of state law like this would be contrary to the Dormant Commerce Clause of the United States Constitution. For example, in \textit{Central GMC, Inc. v. General Motors Corp.},\textsuperscript{28} the court construed the statute so as to avoid conflict with the Dormant Commerce Clause, defining liability as the imposition of a tax or fee on the manufacturer for discontinuing operations in the state. The court described the potential liability as a penalty, which compensates in-state dealers at the expense of out-of-state manufacturers, as one that obviously increases the cost to companies of redeploying their assets throughout the national economy. The parties raised similar Constitutional concerns in \textit{Consumers Oil Corp. v. Phillips Petroleum Co.}\textsuperscript{29} and \textit{St. Joseph Equipment v. Massey-Ferguson, Inc.}\textsuperscript{30}. The opposing view (raised in the context of multi-state agreements) is found in \textit{Instructional Systems, Inc. v. Computer Curriculum Corp.}\textsuperscript{31}

**B. Recent Market Withdrawal Litigation**

1. The End of Oldsmobile

In late 2000, General Motors announced that it would be phasing out the Oldsmobile brand of cars. Sales of the brand had declined from over a million cars annually, to a few hundred thousand.\textsuperscript{32} GM offered dealers a buy-out package, which was ultimately accepted by 97% of the dealers, but there were nearly 100 lawsuits filed by Oldsmobile dealers challenging the market withdrawal or seeking larger payments as damages. The GM buy-out package involved a standard payment of $2,100 per car for each dealer's sales in the best of the most

\begin{itemize}
\item finding that a market withdrawal for economic reasons would be permitted under the Wisconsin Fair Dealership Law); \textit{Lee Beverage Co. v. I.S.C. Wines of Cal., Inc.}, 623 F. Supp. 867 (E.D. Wis. 1985) (manufacturer's sale of product lines for economic reasons was good cause for termination under the Wisconsin Fair Dealership Law).


\item 946 F.2d 327 (4th Cir. 1991).

\item 488 F.2d 816 (3d Cir. 1973).

\item 546 F. Supp. 1245.

\item 35 F.3d 813 (3d Cir. 1994).

\item Many of the facts regarding the end of Oldsmobile are taken from an excellent article by one of the lawyers who represented GM in the litigation that followed. See Leonid Feller, \textit{The Case For Federal Preemption Of State Dealer Franchise Laws: Lessons Learned From General Motors' Oldsmobile Litigation And Other Market Withdrawals}, 11 U. Pa. J. Bus. L. 909 (2009).
\end{itemize}
recent three year period. Dealers with special circumstances, including substantial current capital expenditures, could obtain additional payments.\footnote{Id. at 919.}


The claims generally asserted in litigation where GM could not compel arbitration included breach of contract, tort claims for fraud, negligent misrepresentation, and breach of fiduciary duty, equitable claims for unjust enrichment and statutory claims under state dealer acts.\footnote{Feller, \textit{supra}, at 920.} GM's strategy was to attack the complaints with motions to dismiss, which largely eliminated tort and equitable claims.\footnote{Id.} But as to statutory claims, most cases survived motions to dismiss.\footnote{Id. at 927-28. \textit{See, e.g., Crest Cadillac Oldsmobile, Inc. v. Gen. Motors Corp.}, No. 5:05-CV-OOOS51, 2005 WL 3591871, at *2 (N.D.N.Y. Dec. 30, 2005); \textit{Robert Basil Motors, Inc. v. Gen. Motors Corp.}, No. 03-CV-315A, 2004 WL 1125164, at *4-5 (W.D.N.Y. Apr. 17, 2004); \textit{LaPosta Oldsmobile, Inc. v. Gen. Motors Corp.}, 426 F. Supp. 2d 346, 350 (N.D. W. Va. 2006); \textit{Bob Robinson Chevrolet-Oldsmobile-Cadillac, Inc. v. Gen. Motors Corp.}, No. 5:01CV145, slip op. (Sept. 26, 2002); \textit{Holler Enters. v. Gen. Motors Corp.}, No. 6:04-CV-4S7-ORL-31 KRS, slip op. (M.D. Fla. July 17,2004); \textit{Lokey Oldsmobile, Inc. v. Gen. Motors Corp.}, No. 8:03-CV-1512-T-17-EAJ, slip op. (M.D. Fla. Nov. 26, 2003); \textit{Andrews Oldsmobile Datsun, Inc. v. Gen. Motors Corp.}, No. 8:02-CV-1715-T-27MSS, slip op. (M.D. Fla. Mar. 27, 2003); \textit{Sullivan-Parkhill Holdings, Inc. v. Gen. Motors Corp.}, No. 03J-2032, slip op. (C.D. Ill. Sept. 8, 2003); \textit{Beck Motors, Inc. v. Gen. Motors Corp.}, No. CIV 01-3014, slip op. (D.S.D. Mar. 29, 2002); \textit{Biddulph Arrowhead, L.L.C. v. Gen. Motors Corp.}, No. CIV 02-1914-PHX-EHX, slip op. (D. Ariz. Feb. 18, 2003).} GM was largely successful in opposing statutory claims alleging discrimination in the supply or allocation of vehicles, but was unsuccessful at the motion to dismiss stage in opposing termination or constructive termination claims.\footnote{Feller, \textit{supra} at 924-27.}

GM faced the obstacle that most state motor vehicle statutes prohibit termination or non-renewal without good cause, which is almost always defined in terms of bad acts or breaches by
the dealer.\textsuperscript{40} With respect to the end of the Oldsmobile line-make, however, the dealers had not committed any acts that would allow GM to argue that the dealer was at fault. While some dealer and franchise statutes define good cause in a closed sense, meaning that good cause is only certain defined acts, other state statutes have an open ended definition, meaning that good cause includes the specific enumerated acts by the dealer, but may also include other undefined acts, including, perhaps, the manufacturer's own business exigencies.\textsuperscript{41}

GM faced the challenge that its Oldsmobile dealer agreements did not contain an express provision permitting GM to stop making Oldsmobile products. Dealers asserted three types of breach claims. First, dealers argued that GM had anticipatorily breached the agreement's "renewal" clause, which granted dealers the right to enter into renewals of the agreement so long as the dealer was not in breach. The claim was one for anticipatory breach, because GM had not yet ended the Oldsmobile line, but had announced that it would do so at the end of the current model life cycles. Second, dealers argued that the dealer agreement contained a provision promising a reasonable rate of return, although the provision merely referred to GM's decision whether to locate more or less dealers in a geographic area. Third, dealers argued that there was a provision promising to supply vehicles to the dealers. The actual provision stated that GM would supply vehicles "in quantities adequate to enable Dealer to fulfill its obligations in its Area of Primary Responsibility."\textsuperscript{42} Although GM was successful in obtaining dismissal of some contract claims in some cases, in nearly every case some contract claims survived.\textsuperscript{43}

In the end, only two cases reached the summary judgment stage.\textsuperscript{44} The first case was \textit{C\&O Motors, Inc. v. General Motors Corp.}\textsuperscript{45} There, the dealer alleged multiple contract and statutory claims arising out of the Oldsmobile market withdrawal and GM's alleged actions regarding the dealer's representation of the Nissan line in the same facility. The court dismissed the lion's share of the dealer's claims regarding the Oldsmobile market withdrawal, but the case reached the court with a peculiar stipulation between the parties. The dealer did not allege that GM was obligated to renew the dealer agreement, the dealer having conceded in discovery that GM "had the right to pull the plug."\textsuperscript{46} The only claims relating to Oldsmobile that survived summary judgment were a breach of contract claim that GM failed to provide adequate

\textsuperscript{40} See, e.g., Ala. Code §8-20-5(2); Cal. Veh. Code. § 3060.

\textsuperscript{41} See \textit{Felter v. S.B. Thomas, Inc.}, 63 F.3d 1169 (2d Cir. 1995).

\textsuperscript{42} Feller, supra at 928-29.


\textsuperscript{44} Feller, supra at 928-29.


\textsuperscript{46} \textit{Id.} at *5.
supplies of Oldsmobile vehicles at the tail end of the wind down of the line, but before the expiration of the dealer agreement \(^{47}\) and a claim under the state dealer act that GM failed to:

\[
\text{deliver new motor vehicles \ldots within a reasonable time and in reasonable quantities relative to the \ldots dealer's market area, unless the failure is caused by acts or occurrences beyond the control of the manufacturer.} \quad ^{48}
\]

As to these claims, the court found that there were factual issues that precluded summary judgment.

The second case to reach summary judgment was \textit{Hubbard Auto Center, Inc. v. General Motors Corp.} \(^{49}\). There, the district court granted complete summary judgment to GM. Under the peculiar Indiana motor vehicle dealer statute, GM was permitted to offer a term agreement and there was no statutory violation when GM did not offer a renewal at the end of the Oldsmobile brand. \(^{50}\) The court also found no legal or factual basis for the dealer’s breach of contract claims. Key to the court’s holding was the fact that the dealer could point to no evidence that GM had performed under the dealer agreement through the end of its stated term. \(^{51}\) There was also no evidence that the dealer had been treated differently than other Indiana dealers. \(^{52}\) The court held that the “reasonable return” provision of the dealer agreement was “aspirational” and not a guarantee of an adequate return on the dealer’s investment. \(^{53}\)

2. “Volvoization”

This series of cases began when the European parent of Volvo Construction, the Volvo Construction Equipment Group in Brussels, Belgium acquired the heavy equipment business of Champion Road Machinery Limited (“Champion”) in Canada and Samsung Heavy Industries (“Samsung”) in Korea. \(^{54}\) As a result of these acquisitions, Volvo Construction ended up with significant overlaps in its North American distribution. Pursuant to an ongoing program called “Volvoization,” the products of these acquired construction equipment manufacturers were

\(^{47}\) \textit{Id.} at *6. The contract provision stated that GM would “make available \ldots a mix of vehicles and series of Motor Vehicles identified in the Motor Vehicle Addendum in quantities adequate to enable Dealer to fulfill its obligations in its Area of Primary Responsibility.”

\(^{48}\) \textit{Id.} at *10; W. Va. Code §17A-6A-10(2)(a).


\(^{50}\) \textit{Id.} at *2-3; Ind. Code §23-2-2.7-1(7) and (8). The statute stated: “This chapter shall not prohibit a franchise agreement from providing that the agreement is not renewable upon expiration. . . .”

\(^{51}\) \textit{Hubbard Auto Center, Inc.}, 2008 WL 3874642, at *3-4.

\(^{52}\) \textit{Id.} at *4-5.

\(^{53}\) \textit{Id.} at *6.

\(^{54}\) Co-author Jon P. Christiansen’s law firm, Foley & Lardner LLP, represented the defendants in these cases.
modified in certain ways and rebranded under the VOLVO trademark. Pursuant to an ongoing program of dealer "rationalization," what had previously been three separate dealer networks were consolidated into one network of Volvo Construction equipment dealers.

Numerous cases were filed across the United States. The plaintiffs claimed, essentially, that Volvo’s continued sale of substantially the same products under a different trademark was an unlawful termination and not a permitted market withdrawal. In some cases, the dealers demanded the right to continue the sale of the same products, with the Volvo trademark. Volvo claimed that under the Lanham Act, a dealer not licensed to use the trademark was precluded from selling the trademarked products.

There were several unsuccessful attempts at preliminary injunctions by the terminated dealers.55 A number of the dealers’ claims were decided by the U.S. District Court for the Western District of North Carolina following procedural wrangling over whether the litigation should proceed in Volvo’s home court or in the plaintiffs’ chosen forum, the Eastern District of Arkansas. When the dust settled and after an appeal to the Fourth Circuit, all of the dealers’ claims were dismissed, except one claim under the Arkansas Franchise Practices Act.56 The remaining case went to trial on damages, but the jury returned a verdict that the plaintiff had suffered no damages. The district court denied a motion for a new trial and the plaintiff’s claims for attorney fees57 and the Fourth Circuit affirmed.58

Another case on behalf of multiple dealers was decided by the District Court for the Northern District of Illinois. The trial court dismissed all of the claims on summary judgment,59 and the Seventh Circuit affirmed the dismissals with the exception of one statutory claim under the Maine Franchise Act by one dealer.60 The remaining case went to trial on the issue of whether the franchised goods had been discontinued. The Maine statute specifically provided that good cause existed for terminating a franchise when the franchised goods had been


60 Cromeens, Hollomon, Sibert, Inc. v. AB Volvo, 349 F.3d 376 (7th Cir. 2003), reh’g denied, 2003 U.S. App. LEXIS (7th Cir. Dec. 17, 2003).
discontinued.\textsuperscript{61} The plaintiff argued that the equipment had not been substantially changed by Volvo, so the franchised goods had not been discontinued. Volvo argued that the goods had been changed, but in any event, "franchised" goods included only the "Samsung" trademarked goods and those had been discontinued. The trial resulted in a jury verdict for the plaintiff of $2.1 million. The district court ruled on motions after verdict that the plaintiff was entitled to recover the value of its franchise in perpetuity. On appeal, the Seventh Circuit reversed, holding that under the Maine statute franchised goods only included the trademarked products and not the same products under a different trademark.\textsuperscript{62} Since the plaintiff never had a "Volvo" franchise, "nothing in the statute protects FMS from termination of a franchise it never had."\textsuperscript{63}

3. The Sterling Cessation of Manufacturing.

In 1997 heavy truck manufacturer, Freightliner Corporation, purchased the Ford heavy truck business from Ford Motor Company. Freightliner renamed the line "Sterling" and sold the line through the former Ford truck dealers and through dealers added later. But Sterling was never able to attain an acceptable level of sales and the line lost money in most years. Eventually, the decision was made by Sterling's ultimate parent, Daimler AG to cease manufacturing Sterling trucks as of March, 2009. As with GM's Oldsmobile decision, Sterling offered its dealers a buy-out package that involved a cash payment, termination of the Sterling Sales and Service Agreement and a replacement parts and service agreement. Sterling planned to continue manufacturing replacement parts for the considerable number of Sterling trucks on the road through 2018. As with Oldsmobile, more than 95% of the Sterling dealers accepted Sterling's offer and continued as Sterling service dealers. A handful of dealers, however, pursued litigation.\textsuperscript{64} The dealers claimed that Sterling's announcement that it would cease the production of new trucks was a termination of their franchise agreements without good cause under state motor vehicle franchise laws. They also asserted common law tort and breach of contract claims.

The first reported decision was \textit{L&B Truck Services, Inc. v. Daimler Trucks North America L.L.C.}\textsuperscript{65} from the District Court for the District of Vermont. The case was decided under the Vermont Motor Vehicle Manufacturers, Distributors & Dealers Franchising Practices Act. The court ruled that the decision by Sterling to cease the manufacture of Sterling trucks did not cause a termination of the Sterling Sales and Service Agreement and was not a constructive termination. The Vermont Act defines a "franchise" as "the agreement or contract between the parties,"\textsuperscript{66} including an agreement to perform warranty or other service on the manufacturer's products. The court concluded that the franchise was the written Sterling Sales and Service Agreement. The court also found that Sterling did not terminate or cancel the Sterling SSA as it


\textsuperscript{62} \textit{FMS, Inc. v. Volvo Const. Equip. N. Am., Inc.}, 557 F.3d 758 (7th Cir. 2009).

\textsuperscript{63} \textit{Id.} at 764.

\textsuperscript{64} Co-author Jon P. Christiansen represented the defendants in most of these cases.


pertained to L&B's provision of parts and services to owners and purchasers of Sterling products. It observed that although Sterling discontinued the manufacture of Sterling trucks (as it had reserved the right to do in the Sterling Sales and Service Agreement), L&B could continue to sell parts and provide service for Sterling trucks. The court held that the franchise agreement remained in effect with regard to everything but the sale of new Sterling trucks and that there had been no constructive termination.

The second case was Crossroads Ford Truck Sales, Inc. v. Sterling Truck Corporation, decided under the Illinois Motor Vehicle Franchise Act. In this case, the dealer had originally pursued an administrative protest before the Illinois Motor Vehicle Board, but had voluntarily dismissed the protest to pursue a damages case in state court. After the trial court granted Sterling's motion to dismiss, the Appellate Court affirmed. The plaintiff argued that the Sterling trucks were going to be rebranded as either Freightliner or Western Star trucks, which violated the Illinois Act.

Much of the Appellate Court's decision focused on whether the court had subject matter jurisdiction to hear termination cases, in light of prior amendments to the Franchise Act. But the Appellate Court, like the court in L&B, found that the Sterling Sales and Service Agreement continued, so there was no termination. The Appellate Court affirmed the dismissal of the non-statutory claims in light of the specific provision in the Sterling Sales and Service Agreement permitting the manufacturer to stop making "any or all Sterling Trucks Products."

The dealer also alleged that Sterling's corporate parent intended to rebrand the Sterling trucks under the Freightliner or Western Star brands. The trial court looked to a provision of the Illinois statute (since amended out of the law) declaring that the cessation of manufacturing was good cause for termination and held that even if the trucks were rebranded, the line-make Sterling was ended and that is all the statute required. This issue was not reached by the Appellate Court because of the jurisdictional ruling. The Illinois Supreme Court accepted review and, as of this writing, the matter remains pending before the Court.

The third case was Long-Lewis Sterling Western Star of Bessemer v. Sterling Truck Corp. There, the plaintiff had continually lost money on the sale of new Sterling trucks over the years, but alleged that there had been a termination under the Alabama Motor Vehicle Franchise Act, which triggered an obligation on the part of Sterling to repurchase the dealer's large inventory of unsold new trucks. The dealer also claimed that Sterling would not permit the dealership to operate as a parts and service dealer in the future, which caused millions of dollars in alleged lost profits. The dealer also asserted breach of contract and fraud claims. On summary judgment, the district court found no termination or constructive termination by

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67 L&B Truck Servs., 2009 WL 3584346, at *3.
68 Id.
69 406 Ill. App. 3d 325 (4th Dist. 2010).
70 Id. at 339.
72 Ala. Code §8-20-5.
Sterling’s invocation of the express contract right to stop manufacturing trucks, given the continuation of the dealer’s parts and service business under the Sterling Sales and Service Agreement. The district court also found that Sterling’s express contract provision permitted it to cease manufacturing. As to the fraud claim, the court found that under Alabama law, there was no obligation on the part of the corporate parent of Sterling to advise the dealer that it was considering the cessation of manufacturing.

4. Lessons Learned from Recent Cases

The most important lesson learned from the recent market withdrawal cases is for the manufacturer, where financially feasible, to offer a buy-out package that is attractive to the dealers. As a further example, as of this writing, 98% of the Mercury dealers have accepted the termination package offered by Ford in connection with the phase-out of the Mercury brand. The dealers that have pursued litigation are mainly those who made large facility investments on the eve of the announced termination – and for dealers in that situation, it is not surprising that they will be seeking a recoupment of their investment. In both the Oldsmobile and Sterling cases, a very high number of dealers also “took the package.” That may have been a partial result of the fact that in both cases, most of the dealers retained a relationship with the manufacturer or its parent for other brands, so litigation was a highly undesirable option.

A second lesson is that it helps greatly to have included contract provisions that permit the manufacturer to stop making any or all of the products and to terminate in the event the product line is sold or wound up – although counsel for the dealers may resist such provisions. While the application of state franchise laws will vary with the particular statute involved, the contract provision will apply to each dealer.

Third, it pays to emphasize the trademark, as shown in the Volvoization cases. Courts are leery of requiring a manufacturer to allow dealers to sell under a trademark for which the manufacturer has not licensed the dealer.

But it is also true that the manufacturer does not always win. The interplay between rebranding and market withdrawal was addressed in Larry Hobbs Farm Equipment, Inc. v. CNH America, L.L.C. There, Hobbs entered into a dealer agreement with a predecessor to CNH in 1995 for the rights to sell the DMI brand of machinery. CNH engaged in dual branding of identical tillage and soil management equipment. In late 2004 or 2005, CNH began supplying a competitor of Hobbs with the alternatively-branded but identical tillage and soil management equipment. As a result, Hobbs claimed that the competitive circumstances changed, causing

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74 Id.


76 Similarly, 80% of the Mercury dealers also carry Ford and/or Lincoln. Id. p. 38.

77 For a more complete description of the case, see Joel R. Buckberg & Jon P. Christiansen, Annual Franchise and Distribution Law Developments 2009 p. 54 (ABA 2009).
Hobbs’s sales to drop dramatically. On August 14, 2007, Hobbs received notice from CNH that CNH planned to withdraw DMI-branded equipment from the market. The notice stated that Hobbs’s last day to place orders for DMI-branded goods would be August 31, 2007. The notice also stated that CNH would continue to provide retail programs to assist Hobbs in selling the equipment until August 31, 2008 and would repurchase any unsold equipment at that time.

Hobbs filed suit in the Eastern District of Arkansas, alleging several claims, including violations of the Arkansas Franchise Practices Act ("AFPA"), which has a "closed-ended" definition of "good cause" for termination. On January 22, 2009, the Supreme Court of Arkansas answered certified questions from the District Court. *Larry Hobbs Farm Equip., Inc. v. CNH Am. LLC.* 78 The Arkansas Supreme Court determined that "market withdrawal does not constitute "good cause" under the AFPA, as "market withdrawal" is not included in the eight circumstances specifically listed in section 4-72-202, defining "good cause." The case is a cautionary tale in that even where business conditions compel action by a manufacturer, the rigid application of state franchise laws that do not contemplate market withdrawals can seemingly make franchising a risk free endeavor for the dealer, when it comes to the ultimate success of the products.

VI. CONCLUSION

Like most things in life, the problem of a "disappearing franchisor" is best addressed early: In drafting the agreements and later when the warning signs appear on the horizon. And then, and also consistent with the principle that most important life lessons were learned in kindergarten, honest and open communication among all parties should go a long way towards avoiding unpleasant litigation.

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78 291 S.W.3d 190 (2009).
JON P. CHRISTIANSEN

Jon P. Christiansen is a partner in the Milwaukee Office of Foley & Lardner LLP. Mr. Christiansen practices primarily in the areas of commercial litigation, distribution & franchise and construction. His experience includes preliminary injunctions, trials, arbitrations and appeals throughout the United States in commercial, distribution, construction and trade secret cases. Mr. Christiansen has lectured frequently to trade associations and business groups on the subject of distribution and antitrust law, including, the ABA Forum on Franchising. He has drafted numerous national distribution agreements in diverse industries, has managed distribution channel consolidations, and has counseled with both distributors and manufacturers in resolving distribution disputes. He is one of the principal authors of the "Product Distribution Guide," (2d Ed. 2009) published by CCH. Mr. Christiansen graduated, magna cum laude, from St. Olaf College with a B.A. degree and was awarded his J.D. degree in 1975 by Vanderbilt University, where he was elected to the Order of the Coif and served as editor-in-chief of the Vanderbilt Law Review.

Mr. Christiansen has been selected by his peers for inclusion for more than a decade in The Best Lawyers in America® in the fields of "Bet the Company" litigation, commercial litigation and franchise law. He has also been listed in Chambers USA: America's Leading Business Lawyers (2003-2011). Franchise Times selected Mr. Christiansen as one of its "Legal Eagles." He was also selected for inclusion in the 2005-2011 Wisconsin Super Lawyers® lists.
CARMEN D. CARUSO

Carmen Caruso, a trial and appellate attorney in Chicago, concentrates in franchise & dealership litigation on behalf of clients in all industries. His firm represents franchisees, dealers and their independent associations in litigation or arbitration on a nationwide basis. Carmen has also represented numerous franchisors, including the world's largest, and he served as an arbitrator in a franchise termination case.

Mr. Caruso graduated from Loyola University of Chicago School of Law (1983) and Marquette University (B.A. 1980). He has been active in the Forum since 1997 and has repeatedly been named an Illinois "Leading Lawyer" and Illinois "Super Lawyer."

Mr. Caruso's firm practices in "the Chambers" - a suite of independent trial lawyers with the capability of litigating cases of any size anywhere.