The Unwritten, Unintended, Accidental Franchise Agreement

by Alon Stein

Countersuing For Breach of Franchise Agreement or Wrongful Termination of Franchise Agreement When There Is No Actual Formal Written Franchise Agreement

Your client tells you that its exclusive supplier has terminated its exclusive distribution agreement that it had with your client, without formal notice and without an opportunity to cure breaches, if any.

Since your client's entire business model was based solely on selling the exclusive supplier's products, your client's business was being effectively starved out of business when the contract was terminated.

To add insult to injury, the supplier has now also sued your client because it has not paid for the products that it purchased immediately before the termination.

Your client tells you that, throughout the course of the relationship, it felt as if it were a franchisee of the supplier, even though no formal franchise agreement was ever signed, because it was required to purchase marked-up products from the supplier and it was prohibited from selling any other products in its showroom other than the supplier's products.

In addition, the client was required to display promotional materials and logos of the supplier in its showroom and the supplier promoted your client to the public on Facebook, Twitter and Instagram as being one of its "branches" or one if its "offices."

Can your client counter sue for breach of/wrongful termination of a franchise agreement if there was no actual written executed franchise agreement?

The short answer is that, in Illinois, a written franchise agreement is not required for a franchise relationship to be formed. Therefore, unless such an unintended or accidental franchise relationship is properly terminated, the franchisor/supplier can be held liable for wrongful termination of a franchise relationship. Indeed, pursuant to 815 ILCS 705/19 of the Franchise Disclosure Act (the "Franchise Act"), a franchise relationship usually cannot be terminated without providing notice of "good cause" and at least 30 days to cure any defaults.

Specifically, 815 ILCS 705/19 provides as follows:

> "Sec. 19. Termination of a Franchise.
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> (a) It shall be a violation of this Act for a franchisor to terminate a franchise of a franchised business located in this State prior to the expiration of its term except for "good cause" as provided in subsection (b) or (c) of this Section.
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> (b) "Good cause" shall include, but not be limited to, the failure of the franchisee to comply with any lawful provisions of the franchise or other agreement and to cure such default after being given notice thereof and a reasonable opportunity to cure such default, which in no event need be more than 30 days.
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> (c) "Good cause" shall include, but without the requirement of notice and an opportunity to cure, situations in which the franchisee:
> (1) makes an assignment for the benefit of creditors or a similar disposition of the assets of the franchise business;
> (2) voluntarily abandons the franchise business;
> (3) is convicted of a felony or other crime which substantially impairs the good will associated with the franchisor's trademark, service mark, trade name or commercial symbol; or
> (4) repeatedly fails to comply with the lawful provisions of the franchise or other agreement."

It is important to note that the fact that there is no document entitled "franchise agreement" is not dispositive of anything. Distribution agreements can be deemed to be accidental franchises despite the title of the document. *See To-Am Equip. v. Mitsubishi,* 152 F.3d 658, 661-62 (7th Cir. 1998); *Brenkman v. Belmont Mktg., Inc.,* 87 Ill. App. 3d 1060, 1063 (Ill. App. Ct. 1980).

Pursuant to 815 ILCS 705/3, a franchise is a contract or agreement, either expressed or implied, whether oral or written, between two or more persons by which the franchisee markets, sells and/or distributes the franchisor's products under a marketing plan/system prescribed and/or suggested by the supplier that was substantially associated with the supplier's trademark and where the distributor granted the right to engage in such business is required to pay to the franchisor or an affiliate of the franchisor, directly or indirectly, a franchise fee of $500 or greater.

Thus, to prevail, the client will need to show that there was (A) a marketing plan associated with the supplier's trademark and (B) the payment of a marketing fee of $500 or greater.

A. Marketing Plan Associated with Supplier's Trademark.

A relationship could be deemed a franchise when a distributor markets, sells and/or distributes products under a marketing plan/system prescribed and/or suggested by the supplier that is substantially associated with the supplier's trademark.

What is a "marketing plan"? The statute 805 ILCS 705/3(18) provides an answer:

> "Marketing plan or system" means a plan or system relating to some aspect of the conduct of a party to a contract in conducting business, including but not limited to
> (a) specification of price, or special pricing systems or discount plans,
> (b) use of particular sales or display equipment or merchandising devices,
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> *(Continued on next page)*
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> (c) use of specific sales techniques,
> (d) use of advertising or promotional materials or cooperation in advertising efforts; provided that an agreement is not a marketing plan or system solely because a manufacturer or distributor of goods reserves the right to occasionally require sale at a special reduced price which is advertised on the container or packaging material in which the product is regularly sold, if the reduced price is absorbed by the manufacturer or distributor."

Adherence to a marketing plan is defined as "advice given to the purchaser on how to sell the franchisor's product or service." See 14 Ill. Adm. Code § 200.102(a). Also, under Illinois law, the marketing plan need not be required, but merely suggested. 815 ILCS 705/3(1)(a).

In the example described in the beginning of this article, the distributor would have the argument that the supplier had promoted it as being one of its branches or offices and that it was required during the relationship to have promotional materials with the supplier's logo at its showroom. The distributor's argument in essence would be that if it walks like a duck and it quacks like a duck, it's a duck. The supplier's response would most likely be that it did not exercise sufficient control over the client to be deemed a franchise and that the client was free to market on its own at all times.

B. Franchise Fee of $500 or More.

Oftentimes, the supplier will argue that there was no franchise fee because no direct franchise fee was ever charged. However, the franchise fee requirement can be indirect and be present regardless of the designation given to or the form of the fee. *To-Am Equip. v. Mitsubishi*, 152 F.3d 658, 661-62 (7th Cir. 1998); 14 Ill. Adm. Code 200.105.

In *To-Am Equip. v. Mitsubishi*, the Seventh Circuit stated the policy behind the broad and liberal interpretation of what is considered to be a "franchise fee":

> "The sum of $500, all that has to be paid over the entire life of a franchise, is less than small change for most businesses of any size. Furthermore, the regulations explicitly allow this small amount to be paid either in a lump sum or in installments, to be "definite or indefinite" in amount, and to be "partly or wholly contingent" on different, possibly quite unpredictable, variables. In short, the Illinois legislature and the designated Administrator, the Attorney General, could not have been more clear. They wanted to protect a wide class of dealers, distributors, and other "franchisees" from specified acts, such as terminations of their distributorships (franchises) for anything less than "good cause." They might have done so because it is hard to quantify the level of a franchisee's investment in the products or services of the franchisor, and easy for the franchisor to reap the benefits of those investments without full compensation if it can terminate the relationship essentially at will. Or they might have done so based on an empirical assumption (that may or may not be correct--we express no view on the point) that franchisees tend to be weak and in need of a legislative boost in bargaining power. Or the legislature and the Attorney General might have been engaged in wealth distribution, not considering the indirect impact on Illinois citizens. (The Act describes its purpose as being to furnish prospective franchisees with information, and to protect franchisees and franchisors by providing a better understanding of the business and legal relationship between franchisees and franchisors. 815 ILCS 705/2(2). . . . Illinois, like many other states, has made it clear that parties cannot opt out of the coverage of the Act for Illinois franchisees. 815 ILCS 705/41."

Thus, whether or not there was a franchise fee is broadly construed. In addition, courts typically reject the subjective intent of the parties as determinative of whether a franchise relationship is created. *Brenkman v. Belmont Mktg., Inc.*, 87 Ill. App. 3d 1060, 1063 (Ill. App. Ct. 1980) ("None of the criteria set forth in the statute make the subjective intent of the parties a determinative factor in identifying a franchise relation.").

Oftentimes, being required to purchase products from the supplier at marked up prices will count toward the $500 franchise fee requirements. Whether or not a mark-up for which the distributor purchased from the supplier will be considered part of a franchise fee or will instead be considered a bona fide wholesale or retail price is an issue of fact for the jury. *Live Cryo, LLC v. CryoUSA Import & Sales, LLC,* 2017 U.S. Dist. LEXIS 149850 at *17 (E.D. Mich. Sept. 15, 2017); *Blanton v. Mobil Oil Corp.,* 721 F.2d 1207, 1211 (9th Cir. 1983).

Finally, in line with the liberal interpretation as to what counts toward the $500 franchise fee, the regulations interpreting the Franchise Act provide that training programs required by the supplier may be counted toward the payment of a franchise fee. 14 Ill. Adm. Code 200.106 (a)(c).

In conclusion, it is important to be aware that claims can be brought for the breach/wrongful termination of franchise relationships even when there is no written franchise agreement, if certain factors are present. The potential for such a claim should be considered any time that a termination of a distribution agreement is being litigated when the supplier has multiple exclusive distributors.

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