BUSINESS *Litigation*

April 2006

ALM

A SPECIAL SUPPLEMENT TO THE CONNECTICUT LAW TRIBUNE

Franchise Act Goes Where No Law Has Gone Before

Application of state franchise statute leads to atypical decisions

By ALLAN P. HILLMAN

Last October, the U.S. District Court in Hartford upheld a jury verdict in which, for the first time in U.S. history, an insurance company was held to be a "franchisor" and its agents were held to be "franchisees" under a state franchise statute. *Chart v. Nationwide Insurance Co.*, (affirming a $2.3 million judgment in favor of an agent for unlawful termination in violation of the Connecticut Franchise Act (CFA), with $750,000 in attorneys' fees).

Insurance companies usually do not qualify as franchisors, but *Nationwide* did so because the CFA contains only two of the three statutory requirements normally needed to find the existence of a franchise. At least nine other decisions across the country held an insurance company/agent relationship was not a franchise—reasonably so under state franchise statutes.

Allan P. Hillman is a partner at Shipman & Goodwin, where he practices franchise, antitrust and intellectual property law.

Unless the U.S. Court of Appeals for the 2nd Circuit reverses *Nationwide*, however, Connecticut may have morphed into a jurisdiction inhospitable to insurance companies or business in general.

Connecticut's Take On Franchises

The CFA, C.G.S. §§42-133f-g, relates solely to the termination, cancellation or failure to renew a "franchise"

Unless the U.S. Court of Appeals for the 2nd Circuit reverses *Nationwide*, Connecticut may have morphed into a jurisdiction inhospitable to insurance companies or business in general.

relationship, and requires that such action by the "franchisor" be taken only with good cause, normally upon

sixty days' written notice. Lesser notice may be provided in certain unusual circumstances. Good cause includes, but is not limited to, "the franchisee's refusal or failure to comply substantially with any material and reasonable obligation of the franchise agreement . . ." C.G.S. §42-133f(a).

A franchisee which is improperly terminated, cancelled or non-renewed may sue for injunctive relief, damages and attorneys fees, C.G.S. §42-133g(a). All franchises entered into or renewed after October 1, 1973 must be for a minimum of three years. The parties cannot contract away rights under the CFA by a choice of law provision. *R & B Assoc. of Conn. V. Deltona*, Business Franchise Guide (CCH) ¶ 7,525 (D. Conn. 1980).

Nearly all state franchise laws (whether "registration and disclosure" or "relationship" statutes) provide that a franchise exists when:

(a) a franchisee is granted the right to engage in the business of selling or distributing (sometimes also "offering") goods or services under a marketing plan or system prescribed in substantial part by a franchisor;

(b) the operation of the franchisee's business pursuant to that plan or system is substantially associated with the franchisor's trademark, service mark, trade name, logo, advertising or other commercial symbol; and

(c) the franchisee is required to pay, directly or indirectly, an amount of money to become associated with the franchisor, commonly referred to as a franchise fee.

A franchise fee can vary from small amounts for modest-sized or new franchises, to hundreds of thousands of dollars for a McDonald's It can be difficult for companies to avoid characterization as franchisors unless they charge no upfront fee for the privilege of associating with their system. In Connecticut, however, this is no escape valve: no fee is required by the statute.

Non-Exclusive Disaster

While the relationship between the parties need not be "exclusive," as it often is in the normal franchise relationship, the legislative history of the CFA contemplates that a termination must be a "disaster" for the terminated entity in order for the CFA to apply according to the 2nd Circuit. *Grand Light Supply Co. Inc. v. Honeywell Inc.*. Where a supplier's sales account for less than 10 percent, there is no franchise. But according to the District Court, 23-27 percent may be enough, *Speak-Newman Inc. v. E.I. DuPont de Nemours, Inc.*, 1991 WL 318725 (D. Conn. 1991). Nationwide's agents reached the threshold, of course, since they were exclusive agents. (Note also that whether the agents actually "sold" insurance was not controlling. The CFA broadly applies also to the right to "offer".)

Connecticut state and federal courts have identified important factors as: (1) an actual marketing plan; (2) supplier's power over the dealer's resale pricing; (3) supplier's power over hiring/ firing of the dealer's personnel; (4) supplier's power to require training of dealer's personnel; and (5) supplier's power to examine financial records and require an audit. *Hartford Electric Supply Co. v. Allen-Bradley Co., Inc.* (Hartford seems to misconstrue the right to charge wholesale prices with right to control resale price). Other factors include the supplier's right to inspect premises, require uniforms, and impose sales quotas.

Given the agents' substantial association with the Nationwide trademark, the detailed agreement between Nationwide and its agents, and the company's substantial power over basic aspects of its agents' businesses, it was hardly implausible for the court to uphold the jury's finding. But proving a "franchise fee" element is different—no plaintiff in any of the other insurance franchise case has done so.

It will be no easy task for Nationwide to gain a reversal. Likely, it will be up to the legislature to address this "problem", or face the prospect that its franchise statute may render Connecticut a far less business-friendly jurisdiction from a regulatory standpoint. ■

This article is reprinted with permission from the April 2006 edition of THE CONNECTICUT LAW TRIBUNE. © 2006 ALM Properties, Inc. All rights reserved. Further duplication without permission is prohibited. For information, contact ALM, Reprint Department at 800-888-8300 x6111 or visit **www.almreprints.com**. #301-05-06-0001