

Client Alert

FRANCHISE AND DISTRIBUTION PRACTICE GROUP | NOVEMBER 2011

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The Seventh Circuit Court of Appeals Affirms 50% of Business Threshold to Establish a Franchise Relationship under the Connecticut Franchise Act

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The Seventh Circuit Court of Appeals recently affirmed an Illinois district court's grant of summary judgment in a supplier's favor on a distributor's Connecticut Franchise Act ("CFA") claim, holding that the distributor "failed to show that more than 50% of its business resulted from its relationship with [the supplier], and thus failed to establish the requisite franchise relationship." Threshold requirements such as the one at issue before the Seventh Circuit are found in numerous state franchise relationship laws and can serve as an important potential threshold or defense to the assertion of a claim, especially where the relationship at issue is a fractional franchise or otherwise has been predetermined by a legislature not to be significant enough to be worthy of statutory protection.

In *Echo, Inc. v. Timberland Mach. & Irrigation, Inc.*, 2011 U.S. App. LEXIS 21502 (7th Cir. Oct. 25, 2011), Echo, Inc. ("Echo") supplied power equipment products to a Connecticut-based distributor Timberland Machines & Irrigation, Inc. ("TMI") for over four years. Because of TMI's significant financial woes, however, Echo issued a sixty-day written notice terminating the parties' Distributor Agreement. Echo then shifted TMI's New England sales territory to another distributor, Lawn Equipment Parts Company ("LEPCO"). Echo sued TMI in the U.S. District Court for the Northern District of Illinois for unpaid invoices. TMI answered with counterclaims, including violation of the CFA. TMI also filed a separate suit against Echo and LEPCO with allegations parroting its counterclaims against Echo in addition to claims against LEPCO for, among other claims, tortious interference. These two cases were consolidated.

On TMI's CFA claim, the district court granted Echo's motion for summary judgment. To be considered a franchise, and therefore entitled to the CFA's protections, TMI's business would have to be "substantially associated" with Echo's trademark. In this case, the district court found that TMI's business was not "substantially associated" with Echo because Echo products accounted for between only 30 to 35 percent of TMI's total sales and gross profits over the course of the parties' four year relationship. These numbers were below the 50% threshold adopted by cases interpreting the contours of the CFA's "substantially associated" requirement.

TMI appealed, and the Seventh Circuit Court of Appeals affirmed the district court's decision. The Seventh Circuit's ruling is significant because, as it noted, "Connecticut state courts have not weighed in on whether 50% is a strict cut off." By affirming the district court's ruling, the Seventh Circuit has thrown the weight of its authority behind the proposition that "a franchise exist[s] [under the CFA] only where at least half of the plaintiff's business resulted from its relationship with the defendant."

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