

LEGAL DEVELOPMENTS

March 22, 2006

CONNECTICUT SUPREME COURT HOLDS THAT DISTRIBUTOR WAS NOT A FRANCHISEE

The Connecticut Supreme Court has determined that a manufacturer of filtration products did not exercise sufficient control over the marketing plan of one of its distributors to render their relationship a franchise. Accordingly, in *Edmands v. CUNO, Inc.*, a decision released on March 21, 2006, the Supreme Court affirmed a Superior Court decision upholding CUNO's termination of its distributor and sales representative in Connecticut and Western Massachusetts and rejecting the distributor's Connecticut Franchise Act claim.

The falling-out between the defendant manufacturer and its distributor/sales representative, plaintiff Eastern Filter Sales Company, reflects a somewhat common scenario of conflicts and friction resulting from generational succession at the distributorship and a shift in the manufacturer's management style and philosophy over time.

The relationship between CUNO and plaintiff Eastern Filter Sales Company began in 1972. By 1996, the son of one of Eastern's principals had bought out his father's and his father's partner's interests in Eastern. Shortly afterwards, CUNO began documenting Eastern's inability to retain qualified salespersons and Eastern's disappointing sales numbers. Finally, in September 2000, CUNO

notified Eastern in writing that it was exercising its rights under the distributorship and sales representative agreements to terminate both agreements in 60 days. Although the agreements did not require CUNO to have or to state a reason for terminating the agreements, it stated that it had decided to sell its products directly to the territory that Eastern was servicing and that Eastern's performance in its territory was hampered by its inability to hire and keep qualified salespersons.

Eastern then filed suit to enjoin CUNO from terminating the agreements, alleging primarily that (a) CUNO was violating the Connecticut Franchise Act by terminating the agreements without "good cause," (b) CUNO's termination was an unfair trade practice prohibited by the Connecticut Unfair Trade Practices Act ("CUTPA"), and (c) CUNO was breaching the implied covenant of good faith and fair dealing. The trial court found in favor of CUNO on all claims, and Eastern appealed to the Connecticut Appellate Court, from which the appeal was transferred to the Connecticut Supreme Court.

The main issue on appeal was whether the relationship between CUNO and Eastern could properly be characterized as a franchise relationship. Connecticut is one of only 19

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states with a franchise termination act, and the Connecticut Franchise Act, Connecticut General Statutes §§ 42-133e *et seq.*, is generally considered one of the most franchisee-friendly of the 19 statutes.

If Eastern were deemed to be a CUNO franchisee, then CUNO would have been required to follow the procedures of the Franchise Act in terminating the agreements. Since CUNO provided (1) notice of termination in writing, (2) a reason for the termination, and (3) 60 days notice, it complied with the technical requirements of terminations under the Franchise Act and the remaining issue would be to determine whether CUNO had “good cause” to terminate the agreements.

The Court analyzed whether Eastern was a CUNO franchisee. A franchise is defined in the Franchise Act as an arrangement in which the franchisee is granted the right to sell or distribute goods or services “under a marketing plan or system prescribed in substantial part by a franchisor” and in association with the franchisor’s trademark or other commercial symbol.

In focusing on whether Eastern sold CUNO products under a marketing plan or system prescribed in substantial part by CUNO, the Court repeatedly relied on *Petereit v. S.B. Thomas, Inc.*, a federal case that the Connecticut courts have looked to for guidance on the definition of a franchise. **AVH partner Richard S. Order** represented the *Petereit* plaintiffs, who delivered Thomas’ English Muffins to supermarkets and retail stores and demonstrated that S.B. Thomas exercised sufficient control over their daily routine such as the manner in which deliveries were made, the delivery schedule, the stocking of product on the shelves, and the pricing and selection of products that S.B. Thomas substantially prescribed a marketing plan or system for the delivery of the products. Thus, the plaintiffs

proved they were franchisees despite provisions in their “distributor” agreements disclaiming they were franchisees.

In the present case, the Court concluded that Eastern was not a CUNO franchisee. Of the many factors to consider, the Court viewed pricing as “one of the most significant criteria for determining control.” While CUNO exercised control over the prices of Eastern’s sales under the sales representative agreement, it did not exercise control over sale prices under the distributorship agreement and, therefore, did not sufficiently control pricing in the overall operation of Eastern’s business.

The Court also found that CUNO did not exercise sufficient control over Eastern’s staffing, hiring, quantity of product ordered, levels of inventory, or annual sales planning process to constitute a marketing plan or system prescribed in substantial part by CUNO. Accordingly, the Court affirmed the trial court’s findings in favor of CUNO on the Franchise Act claim and on the remaining claims, which depended on the outcome of the Franchise Act claim.

This case restates the crucial role that the manufacturer’s control plays in determining whether the relationship constitutes a franchise under the Franchise Act. Manufacturers like to control various aspects of the relationship to improve sales and assure quality of the products sold under their trademarks. When they exercise too much control, however, they run the risk that a court in a state with a franchise act may deem them to be franchisors subject to termination procedures designed to provide greater protections to franchisees.

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