The Community of Interest Test for Determining Franchise Relationships

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While the existence of a "community of interest" is well-established as a fundamental definitional criteria of a franchise or dealership relationship, two recent cases illustrate that the resolution of the threshold issue of whether a sufficient "community of interest" exists in a given context remains somewhat unpredictable. Indeed, these cases reiterate the lack of a uniform test or set of factors universally applied by the courts in addressing this issue. On the contrary, these two cases show that even when courts purport to apply the law of the same state, they often apply divergent interpretations that lead to contrary results.

Missouri Beverage Co., Inc. v. Shelton Brothers, Inc.

In Missouri Beverage Co., Inc. v. Shelton Brothers, Inc., Bus. Franchise Guide (CCH) ¶ 14,783, 669 F.3d 873, (8th Cir. 2012), the Eighth Circuit Court of Appeals affirmed the trial court’s grant of summary judgment finding that the relationship between a beer importer and a wholesale distributor was not a "franchise" under the meaning of the Missouri Franchise Law ("MFL"). The importer and the distributor entered into an oral agreement pursuant to which the parties agreed that the distributor would purchase beer from the importer, but was not obligated to purchase any particular amount. The distributor conducted two successive annual sampling events for the importer’s beer. The parties never discussed the distributor’s use of the importer’s name or logo in promotional literature, although the importer testified that the distributor could have used the logo if it had made a request. The distributor did not believe that it was obligated to develop the importer’s name or goodwill, and it did not focus on doing so. Over the years, the distributor purchased product from 50 to 100 suppliers, and the importer’s beer never exceeded 1.16% of the distributor’s gross annual sales of all alcoholic products.

After approximately four years of doing business together, the importer stopped providing products to the distributor and sent a letter removing the distributor as its Missouri distributor. Consequently, the distributor sued, alleging that the importer violated the MFL by failing to give proper notice of franchise termination and by unlawfully terminating a franchise.

In reviewing the district court’s grant of summary judgment in favor of the importer, the Eighth Circuit in Missouri Beverage addressed the threshold issue of whether the business relationship between the importer and the distributor constituted a franchisor-franchisee relationship under Missouri law. The court’s initial inquiry was directed to the question of whether the general definition of "franchise" under the MFL applied to liquor supplier-wholesaler business relationships, such as the one at issue, or if those relationships were only subject to the specific definition contained in an amendment to the MFL which referred specifically to liquor wholesalers. The court found that, in addition to satisfying the specific liquor wholesaler franchise definition, the distributor was also required to satisfy the general franchise definition of the MFL, which required proof of the following three elements: "(1) a written or oral agreement, (2) in which a person grants to another person a license to use a trademark or related characteristic, and (3) in which there is a community of interest in the marketing of goods or services."

In applying the MFL’s three-point general definitional test of a franchise, the Eighth Circuit found that neither the second nor the third element of the test had been satisfied. With regard to the second element pertaining to a trademark license, the court noted that the distributor never used the importer’s name in any marketing efforts, never requested to use the importer’s name, and never received express permission to call itself an authorized dealer or to otherwise use the importer’s name. The court thus concluded that the importer did not grant the distributor a "license to use a trade name, trademark, service mark, or relevant characteristic" as a matter of Missouri law.
With regard to the third element of the test, the Eighth Circuit first observed that there is an absence of case law by Missouri courts interpreting the meaning of “community of interest” as used in the MFL. Consequently, the court opted to look to the judicial interpretation of “the very similar” New Jersey and Wisconsin franchise statutes. The court found persuasive the Third Circuit’s interpretation of the New Jersey statute in Cooper Distrib. Co. v. Amana Refrigeration, Inc., 63 F.3d 262, 269, (3d Cir. 1995), where that court distilled the “community of interest” requirement down to the following two-part test: “(1) the distributor’s investment must have been substantially franchise-specific, and (2) the distributor must have been required to make these investments by the parties’ agreement or the nature of the business.”

The Eighth Circuit also found persuasive the Seventh Circuit’s holding in Frieburg Farm Equip., Inc. v. Van Dale Inc., 978 F.2d 395 (7th Cir. 1992). The court reviewed the Wisconsin Fair Dealership Law (“WFDL”) and found that a “community of interest” may exist under one of two circumstances: “(1) when a large proportion of an alleged dealer’s revenues are derived from the dealership, or (2) when the alleged dealer has made sizeable investments (in, for example, fixed assets, inventory, advertising, training) specialized in some way to the grantor’s goods or services and hence not fully recoverable upon termination.”

The Eighth Circuit in Missouri Beverage held that it believed that the Missouri Supreme Court would determine the existence of a “community of interest” under a standard commensurate with those articulated by the Third Circuit in Cooper Distributing and the Seventh Circuit in Frieburg. Judged by that standard, the Eighth Circuit found no “community of interest” existed between the parties because the distributor’s sales of the importer’s products never exceeded 1.16% of its annual sales, the distributor did not use the importer’s name in marketing during the parties’ relationship, and the distributor was not required to make — and did not make — any sizeable investments particular to the importer. The court thus concluded that the distributor could not "reasonably be deemed economically dependent" on the importer or to have "unequal bargaining power in the relationship," such that the relationship was not that of a franchisor-franchisee under Missouri Law.

Kelley Supply, Inc. v. Chr. Hansen, Inc.

In Kelley Supply, Inc. v. Chr. Hansen, Inc. (CCH) ¶ 14,979, 340 Wis. 2d 497, 812 N.W. 2d 839 (2012), the Court of Appeals of Wisconsin came to a different conclusion than that reached by the Eighth Circuit in Missouri Beverage. In so doing, the Wisconsin Court of Appeals repeatedly took exception with the federal court decisions interpreting the Wisconsin Fair Dealership Law (“WFDL”) and reiterated a much more expansive multi-prong test established by the Wisconsin Supreme Court for determining a “community of interest.”

The appellate court in Kelley Supply affirmed the trial court’s decision finding that a "community of interest" existed between a supplier and a distributor of certain cheese products and enjoining the supplier’s termination of the distributor’s dealership for a period of seven years. The supplier and the distributor had maintained a business relationship for more than 25 years. The sale of the supplier’s products accounted for 39% of the distributor’s total sales and 15% of its overall revenue. The parties conducted their business in accordance with two written agreements until the month prior to the expiration of the second agreement, when the supplier informed the distributor that the agreement would not be renewed. The distributor responded with an action seeking injunctive relief prohibiting the supplier from terminating or substantially changing the competitive circumstances of the relationship.

In affirming the trial court’s ruling in favor of the distributor, the Wisconsin Court of Appeals first noted that a dealership exists under the WFDL when there is “(1) a contract or agreement, either expressed or implied, whether oral or written; (2) which grants the right to sell or distribute goods or services, or grants the right to use a trade name, logo, advertising or other commercial symbol; and (3) a community of interest in the business of, offering, selling or distributing goods or services.”

The court in Kelley Supply further observed that the WFDL defines "community of interest" as "a continuing financial interest between the grantor and grantee in either the operation of the dealership business or the marketing of such goods or services." The court then turned to the seminal case of Ziegler Co. v. Rexnord, Inc., 139 Wis. 2d 593, 604-05, 407 N.W.2d 873 (1987), which it said established two guideposts to assist courts in determining whether a "community of interest" exists in a given case. The court explained that "[t]he first guidepost is a continuing financial interest" and the second is "interdependence," which the court defined as "the degree to which the dealer and grantor cooperate, coordinate their activities and share common goals in their business relationship."
The *Kelley Supply* court reiterated the Wisconsin Supreme Court’s finding in *Ziegler* that the purpose of the WFDL is to protect dealers from unfair practices of powerful grantors and, thus, the guideposts of "continuing financial interest" and "interdependence" were designed to "require a person to demonstrate a stake in the relationship large enough to make the grantor’s power to terminate, cancel or not renew a threat to the economic health of the person (thus giving the grantor inherently superior bargaining power)." The court noted that the requirement embodied in these two guideposts would be satisfied if it was proven that the grantor’s action "would have a significant economic impact" on the grantee.

In addressing the degree of economic impact that must be proven by the distributor, the court in *Kelley Supply* rejected the supplier’s argument that the distributor must prove that its dependence on the supplier was so great that the supplier figuratively had the distributor "over a barrel." On the contrary, the court explicitly rejected reliance on "nonprecedential" federal cases that had adopted the "over the barrel" standard as the Wisconsin test and ruled that the following nonexclusive list of 10 factors articulated by the Wisconsin Supreme Court in *Ziegler* must be examined when considering the two guideposts set forth above: 1) the length of the parties’ relationship; 2) the extent and nature of the parties’ contractual obligations; 3) the percentage of time or revenue devoted to the supplier’s products or services; 4) the percentage of gross proceeds or profits derived from the supplier’s goods or services; 5) the extent and nature of the supplier’s grant of a territory; 6) the extent and nature of use of the supplier’s proprietary marks; 7) the extent and nature of the alleged dealer’s financial investment in the alleged dealership; 8) the personnel devoted by the alleged dealer to the alleged dealership; 9) the amount spent on advertising or promotion of the supplier’s products or services; and 10) the extent and nature of any supplementary services provided by the alleged dealer to consumers of the supplier’s products or services.

The court in *Kelley Supply* emphasized that all 10 of these factors must be considered in determining the existence of a "community of interest." Moreover, the court explicitly rejected the two-prong approach relied upon by the Eighth Circuit in *Missouri Beverage* and borrowed by that court from the Seventh Circuit’s interpretation of the WFDL in *Frieburg*. Specifically, the *Kelley Supply* court found that there was no legal authority to support the supplier’s argument that the WFDL defined "community of interest" based upon a determination of "(1) what percentage of the putative dealer’s business is made up of the supplier’s products; and (2) what brand specific investments does the putative dealer have in the supplier’s products."

In rejecting the applicability of this two-pronged test, the court in *Kelley Supply* found that the Wisconsin courts had never ruled "that a community of interest can be disproven as a matter of law based solely on a consideration of the percentage of sales." The court found further that the trial court properly applied the 10 factors of *Ziegler* and, in that context, correctly considered the significance of the 14% of overall sales derived by the distributor from the supplier, as well as the "substantial" investment made by the distributor in furtherance of its business relationship with the supplier, including the expansion of a warehouse, the installation of new commercial freezer facilities, and the installation of a computer system to track transactions with the supplier. The court concluded that these were important considerations in determining the parties’ "continuing financial relationship and in assessing the economic impact of any termination or nonrenewal." Accordingly, the court concluded that a "community of interest" had been proven.

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