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CHOICE OF LAW ISSUES IN FRANCHISE AND DEALERSHIP AGREEMENTS¹

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The enforceability of choice of law provisions in franchise and dealer agreements is frequently litigated. As a general proposition, courts follow the framework established in the Restatement (Second) *Conflicts of Laws* and choice of law provisions are accorded presumptive validity.² Notwithstanding this presumption, a choice of law provision will not be enforced if either of the following two conditions is satisfied:

(a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or

(b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue....³

From the franchisee or dealer's perspective, these exceptions are especially important to the extent that the target franchise or dealership statute "trumps" critical provisions of the parties' contract, such as the franchisor or supplier's "at will" rights.⁴

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² The "Supreme Court has consistently accorded choice of forum and choice of law provisions presumptive validity." *Allen v. Lloyd's of London*, 94 F.3d 923, 928 (4th Cir. 1996), citing *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972).

³ Restatement (Second) *Conflicts of Laws* § 187 (underscore added).

⁴ Minnesota's Heavy and Utility Equipment Manufacturer and Dealer Act, for example, states: "A term of a dealership agreement either expressed or implied, including a choice of law provision, that is inconsistent with the terms of [the Act] or that purports to waive an equipment manufacturer's compliance with [the Act] is void and unenforceable and does not waive any rights that are provided to a person by [the Act]." Minn. Stat. § 325E.0683. Comparable language is present in many dealer statutes. For a state by state discussion of the interplay between contractual choice of law clauses and statutory anti-waiver provisions,

A. When a Franchisor or Manufacturer Hides From its Own Contract

To provide continuity in their many contracts, franchise or dealership agreements will typically provide for application of the law of the state of the franchisor or supplier. However, the real underlying purpose of the provision may be to avoid the more favorable franchise and dealership laws that exist in the dealers or franchisees' states of operation. Often, the franchisor or supplier's chosen state law will have no, or limited, franchisee or dealer protection legislation and, accordingly, the franchisor-supplier typically is arguing for enforcement of its contractual choice of law provision.

A situation that often presents itself, however, is when (i) the dealer is located in a state that does not have a controlling dealership statute, (ii) the manufacturer is located in a state that has a favorable dealer protection law, and (iii) the manufacturer's form contract contains a choice of law provision calling for the application of the law of the manufacturer's home state.⁵ Notwithstanding the manufacturer's inclusion of that choice of law provision in *its* form contract, the manufacturer will more than likely insist that its home state's dealer law should not apply. While the resolution of the issue will often be sidetracked with arguments by the manufacturer that the "extraterritorial" application of the manufacturer's home state's law to a dealer in a distant state threatens the very fabric of federalism and the Commerce Clause of the Constitution of the United States, the issue is generally capable of being resolved by simply reading the express terms of the dealer law that the manufacturer is trying to avoid.

One of the earliest dealer protection laws is the Wisconsin Fair Dealer Law (the "WFDL").⁶ In a string of decisions from appellate courts in Illinois and in the Fifth and Sixth federal circuits, all arising under the WFDL and all addressing the identical contractual choice of law provision, these "extraterritorial" arguments have been well addressed.

In *Keller v. Brunswick Corp.*,⁷ the plaintiff operated a Mercury Marine dealership in Illinois. The defendant, Brunswick Corporation, manufactured and sold Mercury Marine products to its dealers from its Wisconsin-based factory and office.⁸ The parties' dealership agreement fixed the term of the dealership at one year, and gave Brunswick the right to terminate "without cause at any time upon thirty (30) days written notice".⁹ The dealership contract further provided that Brunswick was "under no obligation, either express or implied, to relicense Dealer upon expiration of this contract or in the event

see Allan P. Hillman, *Public Policy Versus Choice of Law—Is the Best the Enemy of the Good?*, 26 Franchise L. J. 180 (Spring 2007).

⁵ These issues arise in both the franchise and dealership context. For simplicity, we will hereafter generally refer to both franchisees and dealers as "dealers," and to franchisors, manufacturers and suppliers under the collective "manufacturers."

⁶ Wisconsin Fair Dealer Law, Wis. Stat. §135.01 *et seq.* The WFDL applies fully to both dealers and franchisees.

⁷ *Keller v. Brunswick Corp.*, 369 N.E.2d 327 (Ill. App. 1977).

⁸ *Id.* at 328.

⁹ *Id.*

of termination prior to expiration.”¹⁰ Critical to the discussion here, the dealership contract contained a choice of law provision which provided that “the agreement and all of its provisions are to be interpreted and construed according to the law of the State of Wisconsin.”¹¹

On short notice and without any opportunity to cure its purported defaults, Brunswick notified the plaintiff that its dealership would be terminated and not renewed at the end of its term. The dealer sued Brunswick, asserting claims under the WFDL which prohibited terminations and nonrenewals without good cause, without giving notice of the dealer’s purported deficiencies, and without giving a period of time to cure any claimed deficiency.¹² Brunswick argued for the enforcement of the contract as written. It further argued, notwithstanding the Wisconsin choice of law provision in the dealership contract, that the WFDL should not be applied to the contract. The Illinois court of appeals rejected Brunswick’s argument, stating:

[W]e reject that argument as not being in accordance with Wisconsin law.... While the parties may have intended to make a limited choice of Wisconsin law in this case, i.e., a choice of the Wisconsin law necessary to interpret only the ambiguous terms of their agreement, we cannot allow such an agreement to violate the clear requirements of the Wisconsin fair dealership law which was in effect when the parties entered their contract. Because theirs was a Wisconsin contract, we have no hesitation in enforcing the clear requirements of the Wisconsin statute.¹³

The case was remanded to the trial court with directions “to reinstate plaintiff’s complaint and to enforce the provisions of the Wisconsin Fair Dealership Law, striking those provisions of the contract which are inconsistent with the Wisconsin law.”¹⁴

The identical Brunswick dealership contract, containing the same Wisconsin choice of law provision, came before the Fifth and Sixth Circuit Courts of Appeal in *C.A. May Marine Supply Co. v. Brunswick Corp.*¹⁵ and *Boatland, Inc. v. Brunswick Corp.*¹⁶ In *Boatland*, the Sixth Circuit concluded that

the parties intended Wisconsin law to apply to the contract. The Wisconsin law as applied to the contract includes the substantive laws of that state in determining the parties’

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

¹³ *Keller v. Brunswick Corp.*, 369 N.E.2d 327, 329 (Ill. App. 1977).

¹⁴ *Id.*

¹⁵ *C.A. May Marine Supply Co. v. Brunswick Corp.*, 557 F.2d 1163 (5th Cir. 1977).

¹⁶ *Boatland, Inc. v. Brunswick Corp.*, 558 F.2d 818 (6th Cir. 1977).

rights and obligations. Since the Wisconsin Fair Dealership Law is part of the substantive law of Wisconsin it applies on its face to this contract.¹⁷

Brunswick argued that the Wisconsin legislature never intended its statute to “have extraterritorial effect and apply to dealers like Boatland doing business outside of the state.”¹⁸ The Sixth Circuit held:

There is no evidence the Wisconsin legislature intended to restrict the territorial application of the statute, or to prevent anyone, particularly a Wisconsin resident, from making Wisconsin law applicable to his contract. Since Brunswick, a Wisconsin resident, contracted to have Wisconsin substantive law applied to the contract, it cannot be heard now to complain about the extraterritorial application of the Wisconsin law.¹⁹

In *C.A. May Marine Supply Co. v. Brunswick Corp.*, the Fifth Circuit rejected the same arguments that had been made to the Sixth Circuit in *Boatland*. With regard to Brunswick’s argument that it was not the intention of the Wisconsin legislature to extend protection to out-of-state dealers, the court held:

The argument has surface appeal, but is decidedly a red herring. Obviously, the legislature passed the law to protect Wisconsin dealers, and had no concern for protecting the termination rights of dealers such as plaintiff. But that does not mean that parties, one or both of which have some reasonable contact with the State of Wisconsin, may not agree to clothe themselves with the rights and duties of citizens of that state when determining their respective rights under their contract. No state intends to govern the transactions of citizens of other states when it establishes laws governing contractual relations between parties. When, however, parties to a contract have contact with more than one state, the parties are expected, and encouraged, to stipulate which state’s substantive law will govern. Obviously, when such agreement occurs, both parties are bound as well as protected by the state law stipulated. The defendant seems to believe that it may receive the benefits of Wisconsin law, but that plaintiff may not, because it is not a Wisconsin corporation. It suffices

¹⁷ *Id.* at 821 (internal citations omitted).

¹⁸ *Id.* at 822.

¹⁹ *Id.*

to point out that such a notion would effectively emasculate all contractual choice of law provisions....²⁰

In each of the above cases, the manufacturer chose its home state's laws for its dealership contracts' choice of law provision, while the terminated dealers were operating in states other than the manufacturer's home state. In each case the appellate court ruled that the contract's choice of law provision entitled the dealer to the protection of the dealership statute in the manufacturer's home state. The Wisconsin Fair Dealership Law contained no express limitation or exclusion which restricted its coverage to that state's dealers only. Absent such a restriction, the Wisconsin law was held to form a part of the substantive law of the state contractually chosen by the parties.

After the above decisions were rendered, the WFDL's definition of "dealer" was amended to limit the reach of the WFDL to "a person who is a grantee of a dealership situated in this state."²¹ That express change in the articulated scope of the statute resulted in a completely different result when the WFDL and a Wisconsin choice of law clause once more came before Sixth Circuit. In *Bimel-Walroth Co. v. Raytheon Co.*,²² a terminated Ohio dealer sought protection under the Wisconsin Fair Dealership Law premised upon the parties' Wisconsin choice of law provision in the dealership agreement. The court noted the significant, and dispositive, change to the text of the WFDL subsequent to its decision in *Boatland*. The court held:²³

The Wisconsin legislature, however, did amend the WFDL in 1977 by adding the language that is at issue in this case: "dealer" means a person who is a grantee of a dealership situated in the State of Wisconsin." It is logical to assume that this amendment came about in response to the decision in *Boatland*. As analyzed by the Wisconsin court in *Swan Sales [Corp. v. Jos. Schlitz Brewing Co.]*, 126 Wis.2d 16, 374 N.W.2d 640 (Wis. Ct. App. 1985), ... "This... [legislation] establishes the legislature's intent to make the WFDL apply exclusively to *dealerships that do business within the geographic confines of the State of Wisconsin.*" 374 N.W.2d at 644....

The intervening *Swan Sales* decision of the Wisconsin appellate court following the amendment to WFDL makes it plain... that the WFDL does not apply to a plaintiff located outside Wisconsin.

This same approach has been applied by courts evaluating the application of other states' dealer (or franchise) laws that, pursuant to a contractual choice of law provision, are sought by dealers to be applied to their dealerships. In *McDonald's Corp.*

²⁰ *C.A. May Marine Supply Co.*, 557 F.2d at 1166-67 (internal citations omitted).

²¹ Wis. Stat. § 135.02(2).

²² *Bimel-Walroth Co. v. Raytheon Co.*, 796 F.2d 840 (6th Cir. 1986).

²³ *Id.* at 842-43.

v. C.B. Management Co.,²⁴ for example, an Ohio franchisee sought protection under the Illinois Franchise Disclosure Act based upon an Illinois choice of law provision in the franchise agreement. The district court first noted the critical language in the Illinois Franchise Disclosure Act that “[i]t shall be a violation of this Act for a franchisor to terminate a franchised business *located in this state* ... except for ‘good cause’....”²⁵ The district court then concluded that “[i]n accordance with this manifestation of legislative intent, we will not apply the IFDA to the franchisees in this case.”²⁶ Further, the district court found that “where a contractual choice-of-law provision refers the parties to a state law, like the IFDA, which by its express terms does not apply to them, we think it is only by a strained analysis of the principles of choice-of-law that the law is nonetheless found to apply.”²⁷ The Seventh Circuit Court of Appeals has applied the same approach of looking to the express language of the dealer/franchise statute itself to determine if a contractual choice of law provision would require application of the statute.²⁸

B. Enforcing a Manufacturer’s Home State’s Law in the Absence of a Choice of Law Provision

If a state has a dealer statute that does not limit itself to home-grown dealers, it is possible to have that state’s dealer law applied against the wrongful conduct of the manufacturer even in the absence of a choice of law provision designating the law of the manufacturer’s home state. The focus on the location of the dealer or its dealership can often miss the point of the statute altogether. While dealer statutes plainly inure to the benefit of dealers, the focus of some statutes is not so much intended for the protection of dealers as to prevent bad behavior by *manufacturers*. Seen through that prism, the location of the dealer is irrelevant. It is the in-state location of the misbehaving manufacturer that matters.

²⁴ *McDonald’s Corp. v. C.B. Management Co.*, 13 F.Supp.2d 705 (N.D. Ill. 1998).

²⁵ *Id.* at 713 (quoting 815 Ill. Comp. Stat. 705/19).

²⁶ *Id.* at 714.

²⁷ *Id.*

²⁸ See *Cromeens, Holloman, Sibert, Inc. v. AB Volvo*, 349 F.3d 376, 386 (7th Cir. 2003):

The plain language of the Illinois law that the Samsung Dealers seek to apply excludes those same dealers from its coverage because they are located outside of Illinois. Nothing in the Restatement suggests a contrary result. The Restatement excludes from "local law" only the choice-of-law rules of the state, not any territorial limitations contained in the statute. The Samsung Dealers paradoxically argue that the application of the IFDA is required, not by the law of Illinois, but rather by the intention of the parties. This is a circle from which the Samsung Dealers cannot successfully emerge. If they insist (as they must, because the contract chooses Illinois law) that Illinois law applies, then we must look to the law of Illinois to determine the scope of application. The IFDA limits its scope to franchises located within the state, and the Samsung Dealers may not claim its protections.

The case of *Mon-Shore Management, Inc. v. Family Media Inc.*,²⁹ brings this point home. There, the court applied the protections of New York's Franchise Sales Act to out-of-state franchisees because New York has legitimate state interests in protecting out-of-state franchisees from unscrupulous New York franchisors and in "helping to protect and enhance the commercial reputation of the State which, in and of itself, is a legitimate state interest."³⁰ Accordingly, dealer legislation that is expressly, or by inference, intended to curtail the unfair or deceptive trade practices of a state's manufacturer-suppliers would be appropriately applied by a court regardless of the location of the dealer and regardless of the absence of a choice of law provision.³¹

²⁹ *Mon-Shore Management, Inc. v. Family Media Inc.*, 584 F.Supp. 186 (S.D.N.Y. 1984).

³⁰ *Id.* at 191. The three franchise agreements with the three different out-of-state franchisees that were at issue in this case included choice of law provisions designating New York as the operative law. Accordingly, the court concluded:

This provision is sufficient, without more, for New York's Franchise Sales Act to be applied in this litigation. Under New York's conflict of laws doctrine, which we are required to apply in this case, New York will honor a provision in an agreement stipulating that the law of a particular jurisdiction will govern the relations between the parties.

Id. (citations omitted). But the court would have applied New York law regardless of the choice of law provision. "Absent a choice of law clause we believe a New York court would apply New York law in light of the clearly expressed intention of the New York Legislature to exert its fullest power over franchises offered or accepted within its police jurisdiction." *Id.*

³¹ Of course, if the statute expressly limits itself to in-state dealers, that intent would also have to be honored in the application of the statute.