The GPMemorandum

TO: OUR FRANCHISE CLIENTS AND FRIENDS
FROM: GRAY PLANT MOOTY’S FRANCHISE AND DISTRIBUTION PRACTICE GROUP

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This issue of The GPMemorandum focuses primarily on topics of interest to companies that use distributors and dealers rather than manage a business format franchise system. The distribution-related topics this quarter include dealer termination, antitrust, application of state statutes, and more. We do begin, however, with special reports regarding important tax issues and gift card requirements that may impact franchisors more than manufacturers. Summaries of recent legal developments of interest to manufacturers and others who supply products through dealers and distributors begin on page 4.

STATE TAXATION

NEW YORK IMPOSES NEW TAX REPORTING REQUIREMENTS ON FRANCHISORS

The recently enacted 2009-2010 New York State Education, Labor and Family Assistance Budget Bill (Budget Bill) amends the New York Tax Law to impose unprecedented new reporting requirements on franchisors. The relevant text can be found at http://assembly.state.ny.us/leg/?bn=A00157&sh=t in Subpart G, which starts on page 163. These requirements apply to any franchisor with at least one franchisee engaged in taxable sales in New York, although it is not clear how master franchise and area representative relationships will be treated. Under these requirements, a franchisor must file a return on behalf of each of its New York franchisees to report:

- The gross sales of the franchisee in New York as reported by the franchisee to the franchisor
- The total amount of sales by the franchisor to the franchisee
• Any income reported to the franchisor by the franchisee
• The name, address, and New York certificate of authority or federal tax identification number of each franchisee

The first set of returns from franchisors are due on or before September 20, 2009, and must cover the period from March through August 2009. The second set of returns from franchisors are due on or before March 20, 2010, and must cover the period from September 2009 through February 2010. Thereafter, all returns are due annually on or before March 20. While it is clear that franchisors must electronically file all returns with the New York State Department of Taxation and Finance, further instructions regarding these filings are expected to be released any day. In addition to the electronic filings, each franchisor is required to give the franchisee whose information is included in its returns a copy of the information in the returns pertaining to that franchisee.

To help ensure compliance with the new reporting requirements, the Budget Bill adds specific penalties to the New York Tax Law. If a franchisor fails to include required information in its returns or fails to provide a franchisee with a copy of the information in its returns pertaining to that franchisee, the franchisor is subject to a penalty of $500 for ten or fewer failures and up to $50 for each additional failure. If a franchisor fails to file a return on time, the franchisor is subject to a penalty of $500 to $2,000. Total liability for the filing failures described above may not exceed $10,000 for any annual filing period. In addition, if the Commissioner imposes penalties and later determines that the failures that gave rise to those penalties were entirely due to reasonable cause and not due to willful neglect, the Commissioner must remit the penalties.

Although the new reporting requirements arguably apply to every franchisor that has at least one franchisee in the State of New York, the state appears to be targeting larger franchisors and sending them a form letter requesting a list of all of their New York based franchisees. We recommend that franchisors comply with these letters and provide the requested franchisee lists, which in most cases simply involves updating information already in the franchisors’ FDDs. The stated purpose of the request for franchisee lists is to assist New York in making all franchisees “aware of the law change, as well as give them the opportunity to apply for New York’s Voluntary Compliance Program.” This program provides franchisees with the opportunity to “review and correct any of their tax filings with New York without any penalty or threat of criminal prosecution.” Regardless of whether a franchisor receives a letter from New York, it is probably wise for the franchisor separately to alert its New York franchisees of the new reporting requirements and of the Voluntary Compliance Program, especially if the franchisor is concerned that there may be some discrepancies.
The provisions imposing the new reporting requirements on franchisors were added to the Budget Bill late in the legislative process and do not seem to have been openly debated among legislators. Clearly, these provisions are part of a larger scheme in New York to increase revenues in tough economic times by pushing the line of what may be taxed within the state. The International Franchise Association (IFA) opposes New York’s new reporting requirements “as an unconstitutional intrusion into interstate commerce and an aggressive redefining of ‘nexus.’” To counter the trend by New York and other states, the IFA and others in the franchise community are advocating for federal legislation specifically to address and make uniform the nexus required for state taxation. Currently, the IFA’s main focus is on the Business Activity Tax Simplification Act of 2009 (BATSA), which was introduced by U.S. Rep. Rick Boucher (D-VA) in February 2009, and would codify the “physical presence” standard.

Please contact us if you have any questions or concerns relating to your compliance with New York’s new reporting requirements.

**GIFT CARDS**

**NEW FEDERAL REGULATIONS FOR GIFT AND STORED-VALUE CARDS PASSED IN CREDIT CARD ACT OF 2009**

On May 22, 2009, President Obama signed into law the Credit Card Accountability Responsibility and Disclosure Act (Credit CARD Act of 2009), Public Law 111-24. Although the bulk of the new law impacts credit card notices, fees, and collections, Title IV of the Act, entitled Gift Cards, creates federal law prohibiting expiration dates of under five years and certain inactivity fees for electronic gift cards and prepaid stored value cards.

The Act amends the Electronic Funds Transfer Act (codified at 12 U.S.C. § 1693 et seq.) to impose new restrictions on dormancy fees, inactivity charges or fees, service fees, and expiration dates for electronic gift certificates, store gift cards, or general-use prepaid cards. With more detailed regulations not set to be issued by the Federal Reserve Board and Federal Trade Commission until February 22, 2010, vendors and retailers should begin reviewing action steps to comply with the new law before it takes effect on August 22, 2010:

- Review policies and practices on expiration dates. The new law prohibits the sale of cards with an expiration date of less than five years from the date the card is issued.
• Review policies on disclosure of dormancy or inactivity fees. The new law prohibits the use of dormancy fees (other than a one-time issuance fee) unless the card has been inactive for a 12-month period and any fee assessed after a 12-month inactivity period is clearly disclosed at the time of purchase.

• Review compliance with various state unclaimed property and specific gift card laws. This federal law does not preempt state laws on gift cards or unclaimed property unless contrary to federal law. For example, if a state allows for an expiration date of no less than three years for gift cards, the federal law will preempt that state law and make the new expiration date five years from issuance. For details on state gift card laws, as well as the unclaimed property laws in each state, please see the National Conference of State Legislators’ summary of these provisions at http://www.ncsl.org/IssuesResearch/BankingInsuranceFinancialServices/GiftCards andGiftCertificatesLegislation/tabid/12474/Default.aspx

• Paper gift certificates or reloadable stored value cards (like those used by coffee or food services) are not impacted by this law, and are exempted in many state laws.

The Federal Reserve Board and Federal Trade Commission will likely request public comments on the rulemaking for this provision in the fall of 2009, in preparation for publishing regulations in February 2010.

TERMINATIONS

GM, CHRYSLER BANKRUPTCY FILINGS SPUR DEBATE—AND LAWSUITS—OVER DEALERSHIP TERMINATIONS

The recent bankruptcy filings by General Motors and Chrysler have left the auto industry under siege and led to hundreds of dealership terminations across the country. In June, both the U.S. Senate Commerce Committee and the U.S. House Committee on Energy and Commerce held hearings on the status of dealership closures across the country. James Press, President and CEO of Chrysler, testified that Chrysler would be closing 789 dealerships—representing about 25% of dealerships—as a result of the Chapter 11 bankruptcy filing. General Motors’ CEO, Frederick Henderson, testified that by 2010, GM will have shrunk its dealerships by over 1,200. Both executives testified that there may be additional “wind down” terminations announced in the coming year.

As the next article shows, litigation between auto manufacturers and their dealers was commonplace long before bankruptcy filings by GM and Chrysler. The National
Automobile Dealers Association, along with dealerships in many states, however, are fighting this round of terminations through the courts and through their legislators in Congress. For now, it looks as though the courts are continuing to side with the manufacturers, rejecting claims made by terminated dealers in an effort to expedite bankruptcy proceedings. See In re Old Carco LLC (f/k/a Chrysler LLC), et al., 2009 WL 1708813 (Bkrtcy. S.D.N.Y. June 19, 2009) (court found that state dealership laws do not protect dealers from auto manufacturers’ use of the “business judgment rule” to reject current dealership contracts). At least one bill has been introduced in Congress, the Automobile Dealer Economic Rights Restoration Act of 2009, H.R. 2743, that seeks to reinstate the economic rights of terminated Chrysler and GM dealers as part of the bankruptcy restructuring.

Legal challenges have already been made—or at least threatened—on the language used in “Participation Agreements” for dealerships remaining in the system, as well as the “wind down” agreements presented to some dealers. GMAC recently announced the suspension of any financing to Chrysler dealerships, and there have been a growing number of reports that even healthy dealerships have lost channels of inventory needed to survive the slump. These issues look ripe for a new round of litigation likely to emerge in the post-bankruptcy auto industry.

GM’S LITIGATION WITH DEALERS PREDATES RECENT DEALER REDUCTION ANNOUNCEMENTS

Even before its recent bankruptcy filing and widespread dealer reduction announcements, GM was involved in significant litigation with its dealers concerning distribution issues. Five recent cases, briefly discussed below, are representative.

In Courtesy Oldsmobile, Inc. v. General Motors Corp., 2009 WL 1353762 (9th Cir. May 15, 2009), and C&O Motors, Inc. v. General Motors Corp., 2009 WL 891033 (4th Cir. Apr. 1, 2009), the courts concluded that GM did not violate dealer agreements or state motor vehicle franchise laws when it discontinued its Oldsmobile line. In the Courtesy case, the court noted that the agreement did not give the dealer an “absolute” opportunity to enter into a new dealership contract at the expiration date. In addition, the contract’s statement that it was GM’s aim to have the dealer “achieve a reasonable return on investment” was not actionable because the contractual language was “unambiguously aspirational and insufficient to impose an obligation on” the car company. Moreover, the court concluded that the dealer’s statutory claims failed because GM retained complete discretion as to the distribution of vehicles and the dealer had not filed an administrative appeal, which is a requirement for filing suit under the state dealership relationship statute. Finally, there was no violation of Nevada’s unfair trade practice statute because the alleged statements made by GM about which the dealer complained were “not directed at the public” and were not “knowingly false.”
court in C&O reached the same general conclusions with respect to a dealership in West Virginia, holding that its claim for lost profits against GM caused by the phase-out of the Oldsmobile line was barred because the dealer had suffered no economic loss when it opened a more successful Nissan dealership in its place.

However, in *General Motors Corp. v. Harry Brown’s, LLC*, No. 08-3924 (8th Cir. Apr. 16, 2009), and *Saturn of Denville v. General Motors Corp.*, 2009 WL 154559 (D.N.J. May 29, 2009), the courts turned away GM’s attempt to restrict dealers from carrying competing car brands in the extraordinary economic context created by the current recession. In *Harry Brown’s*, the court denied a injunction prohibiting the dealer from combining with a nearby dealer of Chrysler vehicles, which would be stocked alongside GM automobiles, primarily because the “longtime public association of the two dealerships,” their overlapping customer bases and proximity to each other lessened the harm to GM that could usually be expected from selling the two brands of cars under one roof. Similarly, in *Saturn of Denville* the court enjoined GM from enforcing a prohibition on dual branding by a dealer who sought to sell cars from Saturn and KIA. The dispute in that case arose during the midst of the GM’s current restructuring, when the company decided not to continue with the brand in its long-term plans. Given Saturn’s limited advertising, low incentives, and lack of unique models, along with the impending termination of the Saturn brand, the court found it would be an “unreasonable restriction” under the New Jersey Franchise Practices Act for GM to preclude the dealer from combining its Saturn facility with a KIA dealership. Similarly, in *General Motors Corp. v. DealMaker, LLC*, the Eighth Circuit affirmed the district court’s denial of a preliminary injunction barring a dealer’s proposed relocation request and request to carry another line of cars on the grounds that GM’s claims for harm to goodwill and customer relationships was the equivalent to a claim of lost profits, was too speculative in nature, and thus did not rise to the level of irreparable harm.

**FEDERAL COURT APPLIES NEW JERSEY FRANCHISE ACT TO STOP TERMINATION**

Outside the auto industry, a New Jersey federal court recently issued a temporary restraining order prohibiting the termination of a Master Distributor Agreement, finding that the manufacturer likely violated the New Jersey Franchise Practices Act. *Emergency Accessories & Installation, Inc. v. Whelen Engineering Co., Inc.*, 2009 WL 1587888 (D.N.J. June 3, 2009).

Emergency Accessories & Installation (EAI) sells and installs emergency response vehicle equipment. Over 95 percent of its inventory comes from Whelen Engineering, Inc., a manufacturer of emergency lighting, and EAI claims that “[w]ithout Whelen products, EAI [would] have no business.” Whelen issued a notice to EAI terminating the Master Distributor Agreement asserting that EAI’s actions injured the goodwill associated with
Whelen’s trademarks, but without describing the injuries. EAI applied to the court for temporary relief to stop the termination.

The court determined that the New Jersey Franchise Practice Act likely applied to the Master Distributor Agreement because EAI’s business was located in New Jersey, there was a community of interest between the parties, and Whelen licensed the use of its trademark to EAI. As a result, Whelen’s termination of the Master Distributor Agreement was likely in violation of the New Jersey Franchise Practice Act in that the termination letter failed to assert good cause for termination. The court issued a temporary restraining order to stop the termination.

**DISTRIBUTOR’S PREVIOUS TERMINATIONS OF DISTRIBUTORSHIP AGREEMENTS WITH CAUSE DID NOT WAIVE RIGHT TO TERMINATE AT WILL AND WITHOUT CAUSE**

In *Haynes Trane Service Agency, Inc. v. American Standard, Inc.* (10th Cir., reissued as amended July 6, 2009), the manufacturer (Trane) entered into an “at-will” distributorship agreement with the distributor (Haynes) pursuant to which Haynes purchased heating and air conditioning products from Trane for resale to the public. Eventually, Trane terminated the agreement after Haynes cheated Trane by submitting false invoices under Trane’s rebate program. Haynes filed suit against Trane claiming, among other things, that: (1) Trane had improperly terminated the “at will” distributorship agreement and that, based upon past conduct, Trane could only terminate for “good cause;” (2) Trane was equitably estopped from denying that “good cause” was required for termination; and (3) Trane breached its fiduciary duty to Haynes. The district court denied as a matter of law the Haynes claim that the distributorship agreement was modified by course of conduct or that a fiduciary relationship existed between Haynes and Trane. The court also held that Haynes’ own misconduct related to the rebate program precluded application of the equitable estoppel doctrine.

On appeal, the Tenth Circuit agreed that Trane’s termination of the distributorship agreement was valid. The appellate court found that Trane’s historical pattern of terminating other distributors with cause did not modify the distributorship agreement with Haynes because Trane’s conduct involving other distributors was not “unequivocally inconsistent” with Trane’s subsequent enforcement of its distributorship agreement with Haynes. In so doing, the court noted that Haynes presented insufficient evidence that the distributorship agreement had been modified under Wisconsin law, which governed the agreement. The court agreed that Haynes’ submission of fraudulent invoices to Trane under the rebate program constituted unclean hands, and therefore, found no abuse of discretion by the district court in denying equitable estoppel as a remedy to Haynes under Wisconsin law. With respect to the fiduciary duty
claim, the court affirmed the district court’s finding that Haynes failed to establish that the parties had a fiduciary relationship.

STATE FRANCHISE LAWS

NON-MANDATORY SERVICE FEES DO NOT CONSTITUTE “FRANCHISE FEES” UNDER MICHIGAN FRANCHISE LAW

In Kenaya Wireless, Inc. v. SSMJ, LLC d/b/a All Star Wireless USA, 2009 WL 763496 (Mich. Ct. App. March 24, 2009), the Michigan Court of Appeals found that non-mandatory service fees do not amount to “franchise fees” under the Michigan Franchise Investment Law (MFIL). The lawsuit was brought by a wireless phone distributor, Kenaya Wireless, against its communication services provider, All Star. Kenaya claimed it should be considered All Star’s franchisee under the MFIL because All Star allegedly charged an indirect franchise fee by selling Kenaya phones in excess of the “bona fide wholesale price,” charging Kenaya for marketing and internet service fees, and offering other optional services, such as toll-free telephone numbers and customer call centers.

The court found the distributor’s logic unsupported by MFIL’s definition of a franchise. Kenaya Wireless paid no more than a reasonable mark-up for the phones ($10 over its direct cost of $95), Kenaya Wireless was not contractually required to buy marketing or IT services from All Star, and was not required to use and pay for All Star’s toll-free numbers or call centers. None of the purported “fees” was mandatory, and thus, they did not constitute—directly or indirectly—a franchise fee.

ENCROACHMENT

SIXTH CIRCUIT REJECTS DEALER’S ENCROACHMENT CLAIM WHERE CONTRACT DID NOT CONTAIN AN EXCLUSIVE TERRITORY PROVISION

The United States Court of Appeals for the Sixth Circuit has affirmed a Michigan federal court’s grant of summary judgment to defendant ExxonMobil Oil Company, turning aside the appellant-dealer’s encroachment claims because the parol evidence rule barred oral evidence regarding Exxon’s alleged promise to provide the dealer with an exclusive territory. Partner & Partner, Inc. v. ExxonMobil Oil Corp., 2009 WL 1184796 (6th Cir. May 4, 2009).

In upholding the district court’s decision, the Sixth Circuit noted that neither the original sales agreement between Exxon and the dealer nor the subsequent PMPA Agreement between the dealer and its distributor contained a provision granting the dealer an exclusive territory. The Sixth Circuit found that Exxon was within its contractual rights to allow a nearby gas station to rebrand itself as a Mobil station, in
direct competition with the dealer. The appellant’s only evidence of its supposed exclusive territory was alleged oral representations by Exxon. The Sixth Circuit determined those representations were barred by the parol evidence rule as well as the integration clause in the sales agreement between the parties. It also rejected the dealer’s motion to amend its complaint to include breach of the Michigan Franchise Investment Law, finding that Exxon did not have a franchise relationship with either the distributor or the dealer.

DUTY OF GOOD FAITH AND FAIR DEALING

COURT DISMISSES GAS STATION’S GOOD FAITH AND FAIR DEALING CLAIM

A New Jersey federal court recently granted judgment on the pleadings for defendants Getty Petroleum Marketing, Inc. and Lukoil Americas Corp. ( Getty) with respect to a claim that they had breached the implied covenant of good faith and fair dealing in setting the price for gasoline under an open pricing term. Akshayraj, Inc. v. Getty Petroleum Mktg., Inc., 2009 WL 961442 (D.N.J. April 8, 2009). The case began with the plaintiffs’ request for a preliminary injunction to prevent the rebranding of their Mobil gasoline stations to Lukoil. The court denied the request for a preliminary injunction and dismissed all claims from the case except for the plaintiffs’ claim that Getty breached the implied covenant of good faith and fair dealing. The plaintiffs alleged that Getty breached the implied covenant by setting the price for gasoline under the open pricing terms contained in the franchise agreement in an arbitrary, unreasonable, and capricious manner with the intent of depriving the plaintiffs of their reasonable contract expectations.

In granting the defendants’ motion for judgment on the pleadings, the court held that Pennsylvania law applied because, pursuant to the Petroleum Marketing Practices Act, the substantive law of the franchisee’s principal place of business governed the construction of the franchise agreement. In applying Pennsylvania law, the court determined the implied covenant of good faith could not modify or override an express contract term. The court found that the franchise agreement expressly addressed the pricing of gasoline and expressly permitted Getty to charge a price fixed at a place and time ( i.e., its daily terminal or bulk plant price) and to change that price at any time without notice. Thus, the claim for breach of the covenant of good faith was dismissed.
DISTRICT COURT DISMISSES TRUCK DISTRIBUTOR’S SHERMAN ACT §1 CLAIMS

A Pennsylvania federal court recently ordered summary dismissal of a discounting garbage truck distributor’s antitrust claims against Mack Trucks, Inc. for violation of Section 1 of the Sherman Act. The court, however, did allow some of the claims of both parties to proceed. *RDK Truck Sales and Service, Inc. v. Mack Trucks, Inc.*, 2009 WL 1441578 (E.D. Pa. May 19, 2009).

Plaintiff RDK is an independent distributor of garbage trucks, including Mack trucks. It markets itself by “aggressively advertising low prices nationwide,” though its only service facility is in Tampa. Mack has 137 dealers with 200 locations. RDK alleged three unlawful agreements: (1) that Mack conspired with its dealers to deny RDK access to highly discounted Mack trucks; (2) that Mack conspired with co-defendants McNeilus Truck Manufacturing, Inc. and Heil Environmental Industries, Ltd., two of the biggest makers of garbage truck bodies (which are fitted to Mack chassis and are tailored for specific uses), to have them refuse to sell Mack “ready trucks” to RDK; and (3) that Mack entered into another three-way agreement with McNeilus and Heil to ensure that neither would sell to established customers of Mack dealers, the kind of customer RDK asserted itself to be. In granting summary judgment for the defendants on these claims, the district court held that RDK failed to provide sufficient evidence of any of the alleged agreements to create a triable issue, and that the circumstantial evidence proffered by RDK did not tend to show the existence of such agreements rather than lawful independent—though parallel—action. The court contrasted RDK’s lack of evidence with the direct evidence of conspiracy found in *Toledo Mack v. Mack Trucks, Inc.*, which was summarized in Issue 110 of *The GPMemorandum*.

RDK was allowed to proceed on claims under the Florida Deceptive and Unfair Trade Practices Act and for tortious interference. RDK also failed to obtain summary dismissal of most of Mack’s counterclaims, which accused RDK of civil conspiracy and violation of the Florida DUTPA by defrauding Mack into giving RDK the benefit of certain discounts to which it was not entitled.

PENNSYLVANIA FEDERAL COURT TAKES BROAD VIEW OF “COMPETITORS” IN ROBINSON-PATMAN ACT CLAIM

In *Feester’s, Inc. v. Michael Foods, Inc.*, No. 1:CV-04-0576 (M.D. Pa. April 27, 2009), the United States District Court for the Middle District of Pennsylvania ruled that a food manufacturer’s pricing structure violated the Robinson-Patman Act’s prohibition on price discrimination. The price discrimination claim arose in the arena of the supply of
food products to institutional food service providers, such as schools and hospitals. Institutional food service providers generally obtain food products in one of two ways. An institution is either a “self-operator” that manages its food service operation internally, in which case the institution negotiates prices and purchases products from a variety of distributors. Or, an institution will engage a food management company to manage all aspects of the institution’s food service operations, including the purchase and delivery of food products. The defendant, a large manufacturer of egg and potato products, utilized a pricing structure that resulted, according to the court’s findings, in drastic product discounts to Sodexho, a multi-national food management company (and a co-defendant), as compared to plaintiff Feeser’s, a distributor operating on a regional level.

Price discrimination under the Robinson-Patman Act requires that the plaintiff prove, among other things, different prices being charged to two parties that are in competition with one another. Here, the defendant argued that the vastly different services provided by distributors (such as the plaintiff) and food management companies (such as Sodexho) required a finding that plaintiff and Sodexho were not competitors. The Third Circuit’s prior remand order in the case had instructed the district court to analyze carefully the underlying facts to determine whether the purported competitors “compete to resell food products to the same group of customers” and are “each directly after the same dollar.” On remand, the district court found that: (1) institutions routinely switch between acting as self-operators that buy directly from distributors to utilizing the services of food management companies; (2) specific customers had switched from buying from plaintiff to buying from and using Sodexho’s services; and (3) Sodexho’s internal documents characterized food distributors like the plaintiff as competitors. Relying on these findings, and taking a broad view of the notion of “competitors,” the court ruled that plaintiff and Sodexho do “compete” for the same food service customers, for purposes of the Robinson-Patman Act. The court enjoined the defendant from further price discrimination against the plaintiff.

In a subsequent ruling, the court held the defendant in contempt of the April 27 order. The defendant had apparently refused to sell directly to the plaintiff altogether, forcing the plaintiff to purchase through a different reseller at an even higher price. The court found that the defendant was attempting to avoid the effect of the order by simply inserting an additional link in the distribution, which also was held to be unlawful.
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