The GPMemorandum, Issue 102

January 01, 2008

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IN THIS ISSUE:

This issue of The GPMemorandum focuses on topics of interest to companies that use distributors and dealers rather than managing a system of franchisees. Here are summaries of some of the most recent case decisions of interest to manufacturers and others who supply products through dealers and distributors:

DISTRIBUTOR AND DEALER TERMINATIONS

CHANGE OF BUSINESS MODEL BY MANUFACTURER JUSTIFIED NON-RENEWAL OF DISTRIBUTOR

A federal court in Minnesota has refused to stop the non-renewal of a distributor of coin-operated tire-inflator machines and automobile vacuums in William McCabe v. AIR-Serv Group, LLC, 2007 WL 4591932 (D. Minn. Dec. 28, 2007). The change was part of the manufacturer's business model shift that had resulted in reducing distributor ranks from 130 down to four. Most of the reduction occurred through non-renewal of distribution agreements at the end of their terms. This distributor's lawsuit claimed protection under the Minnesota Franchise Act and on other grounds.

In denying an injunction to prevent the loss of the distributorship, the court ruled that whether or not the Minnesota statute applied (which the court did not decide), the manufacturer's action was proper. The manufacturer's change of business model to perform service on its machines directly, rather than through distributors, was a legitimate business justification. The manufacturer had given ample warning of the change, including formal written notice more than nine months in advance.

MISSOURI COURT ADDRESSES CHALLENGE TO EXPERT OPINION ON DEALER TERMINATION DAMAGES

A dealer named Tri-State Hardware filed a three-count petition in federal court in Missouri alleging that John Deere wrongfully terminated Tri-State's right to sell the manufacturer's line of products and services. Tri State Hardware, Inc. v. John Deere Co., 2007 WL 4287867 (W.D. Mo. Dec. 6, 2007). In support of its claims, Tri-State submitted a certified public accountant's opinion on future profits allegedly lost because of the termination. The court generally allowed the affidavit, as there were reasonable disputes between the parties over both assumed facts and proper methods of calculating damages, and the expert's decision to assume facts as alleged by the plaintiff and to opt for one damages calculation method over another did not render his report inadmissible.

The court did, however, find that the expert's report and affidavit was deficient in several respects. Most notably for parties in other cases, the court struck all portions of the report that related to the son of Tri-State's owners/operators. The report calculated damages beyond the owners' life expectancy on the assumption that their son would take over the business. The court found that assumption to be overly speculative.

PART OF LAWSUIT ALLOWED TO STAND AGAINST MANUFACTURER THAT SOUGHT TO SELL DIRECT TO DEALERSHIPS

Cole's Tractor & Equipment, Inc. was both a dealer and distributor for Homier Distributing Company, Inc., which sells and distributes Farm Pro tractors, implements, tools, small engines, and related products. Homier sent a notice of termination to Cole due to Cole's alleged failure to actively develop its territory and its severely declining sales performance. The notice specified that Cole had not, however, lost its "status as a dealer of Homier Farm Pro product lines." Cole sued Homier in federal court, alleging that Homier had impermissibly contacted the dealerships to which Cole sold Homier products and asked them to buy directly from Homier. Cole v. Homier Distrib. Co., Inc., 2007 WL 4233636 (E.D. Mo. Nov. 28, 2007)

The United States District Court for the Eastern District of Missouri granted in part and denied in part manufacturer Homier's motion to dismiss the claims. The court dismissed Cole's claim that Homier tortiously interfered with Cole's relationships with its dealers because "[Cole] only established the dealerships in response to their Agreement with [Homier]. [Cole] did not have a preexisting relationship with any of these dealerships, which courts require a distributor to have with a buyer before a tortious interference claim can go forward against the distributor's supplier." The court also dismissed the fraud claim because Cole had not alleged any false representations in support of the claim.

The court allowed Cole to proceed with its claim under the Missouri Merchandising Practices Act, however. The MMPA requires at least 90 days advance written notice to cancel, terminate, or fail to renew a "franchise," which the Act defines as "a written or oral agreement for a definite or indefinite period in which a person grants to another person a license to use a trade name, trademark, service mark, or related characteristic, and in which there is a community interest in the marketing of goods or services at wholesale, retail, by lease, agreement, or otherwise". Homier did not argue that its relationship with Cole was not a "franchise" under the Act. Instead, it claimed that the Act did not apply because it does not create a claim for the "constructive termination" that Cole alleged. The court disagreed, citing Eighth Circuit precedent holding that a franchisor cannot "in effect terminate" the franchise during the 90-day notice period because to do so would render the Act meaningless. Cole's pleadings alleged that Homier effectively terminated its franchise before the 90-day period ran by contacting its dealers directly and by no longer giving Cole sales leads. The court found that those allegations, if true, would establish an MMPA violation.

FEDERAL COURT REFUSES TO STOP TERMINATION OF GAS STATION OPERATOR UNDER PMPA FOLLOWING FRANCHISOR LOSS OF LEASE

The United States District Court for the Northern District of California recently denied a gas station franchisee's motion for preliminary injunction against a franchisor in a dispute under the Petroleum Marketing Practices Act. Houtan Petroleum, Inc. v. ConocoPhillips Company, U.S. Dist. LEXIS 86869 (N.D. Cal. Nov. 16, 2007).

Houtan had operated a Union 76 gas station as a Conoco franchisee at the same location for 10 years. While Conoco owned the structures, equipment and improvements at the station, it did not own the station property but instead leased it from a third-party. When Houtan and Conoco renewed their franchise agreement, Conoco's station lease with the third party was set to expire two months thereafter unless Conoco was able to renew the lease. When Conoco was unable to do so, it terminated the franchise agreement. Shortly after Conoco terminated the franchise agreement, Houtan entered into a lease for the station with the same third party and demanded that Conoco sell Houtan its equipment and improvements on the station property. Houtan rejected Conoco's offer price, and Conoco attempted to remove its equipment and improvements from the station. Houtan subsequently sued Conoco alleging that Conoco had violated the PMPA in three respects: (1) terminating the franchise agreement without good faith or in the normal course of business; (2) failing to give 90 days notice before terminating the franchise; and (3) failing to make a bona fide offer to sell the equipment and improvements of the station to the franchisee. Houtan also moved to enjoin Conoco from taking any further action to interfere with Houtan's immediate assumption of control of the station.

The district court denied Houtan's motion, holding that the parties' disagreement as to the value of the equipment and improvements was not grounds for a preliminary injunction but was a factual dispute to be resolved by the trier of fact. Moreover, the court found that under the preliminary injunction standard described in the PMPA, there were not sufficiently serious questions going to the merits of Houtan's claims for wrongful termination to warrant granting a preliminary injunction. Specifically, the court found that Houtan and Conoco renewed their franchise agreement with the express understanding that it would be terminated if Conoco was unable to renew the station lease, and Houtan was on notice of this fact well in advance of the 90-day notice required by the PMPA.

OREGON FEDERAL COURT HALTS DEALER TERMINATION PENDING DETERMINATION OF GOOD CAUSE

The United States District Court for the District of Oregon recently upheld a temporary restraining order that it had issued at the request of a motorcycle dealership, finding that Oregon's Motor Vehicle Dealerships Act requires courts to maintain the status quo between a dealership and manufacturer while the court determines whether good cause for termination exists. Everything Cycles, Inc. v. Yamaha Motor Corp. U.S.A, 2007 U.S. Dist. LEXIS 79396 (D. Or. Oct. 25, 2007). Yamaha's attempted termination of the dealership arose out of the felony conviction of the dealership's principal stockholder, for purchasing stolen vehicle parts on the internet. The conviction caused the dealership to lose its business license to operate in the city in which the authorized site of the dealership was located. As a result, the dealership moved to a different city. Because the dealership failed (in Yamaha's opinion) to provide adequate information regarding the new location, Yamaha withheld approval of the relocation and subsequently terminated the dealership, citing various defaults stemming from the unauthorized relocation.

Upon Yamaha's motion to reconsider the TRO, the court determined that, in enacting the Motor Vehicle Dealerships Act, the Oregon legislature had intentionally tipped the balance of power in favor of dealerships by requiring a court to determine whether "good cause" for termination exists whenever a termination decision is challenged. Because it is for the court to determine "good cause" in the first instance (as opposed to reviewing the propriety of the manufacturer's determination of good cause), the court found the preliminary injunction appropriate. Notably, the court refrained from analyzing the underlying merits of the case, and noted that "the court may very well find good cause based on plaintiff's relocation."

ANTITRUST

In its last two terms, the United States Supreme Court issued two important rulings that are having an impact on pricing practices and relationships with distributors and dealers. As a review, we recap our prior articles on those two decisions:

SUPREME COURT REVERSES BAN ON VERTICAL PRICE FIXING

For as long as anyone alive today can remember, federal antitrust law has prohibited suppliers from setting minimum resale prices based on a century-old precedent. Last summer, the United States Supreme Court, in Leegin v. Creative Leather Products, Inc., 2007 WL 1835892 (U.S. June 28, 2007), reversed that long-standing precedent, ruling that all such agreements are now subject to the "rule of reason," a method of analysis under which the claimant must make the difficult showing that the arrangement harms competition substantially in the market as a whole. This decision is expanding the ability of franchisors to design flexible pricing programs.

Under the old Dr. Miles case, it had been per se illegal for a franchisor or supplier to enter into an agreement with a reseller over its minimum retail prices. Cases focused on whether the manufacturer or other supplier met the technical requirements of reaching an "agreement." In order to avoid per se illegality, suppliers were permitted to "announce" their policy and decide to deal with those who complied with the policy. This created an artificial structure in which a supplier could establish a minimum price but could not reach or enforce agreements on that policy.

The Supreme Court's decision in Leegin means it is no longer necessary for suppliers to engage in the appearance of suggesting but not agreeing. Under federal law at least, companies now can direct specific resale prices to be charged, need not utilize agency or consignment arrangements in order to direct prices, need not adopt cumbersome "minimum advertised price programs," and no longer need to exercise extreme caution to avoid "agreements" (as opposed to unilateral actions) with distributors or dealers on the prices to be charged.

Leegin was a typical minimum resale price case in which a discounting retailer was terminated for excessive discounting. In its 5-4 decision, the Supreme Court found resale price maintenance to be generally pro-competitive because: (1) it can help ensure that retail services that enhance interbrand competition will not be underprovided (e.g., because of free riding); and (2) it may facilitate market entry for new companies and brands. As the Court noted, similar justifications have supported "rule of reason" analysis for non-price vertical agreements (such as exclusive territories) for decades.

Manufacturers and other suppliers should be cautioned, however. Minimum resale prices can still be challenged under the "rule of reason." In those situations in which price limitations clearly harm consumers and the franchisor has "market power", there may be competitive concerns raised. Moreover, while many state laws typically follow federal antitrust decisions, such as the Leegin decision, it remains to be seen whether states will continue to apply the per se rule to resale price maintenance. Finally, as the Court cautioned, resale price maintenance can be used as a tool to facilitate collusion among retailers or suppliers. The majority opinion cautioned lower courts "to be diligent in eliminating [the] anticompetitive uses" of resale price maintenance from the market. Thus, careful guidance in establishing resale price policies is prudent; collusion with competitors must be avoided.

SUPREME COURT REVERSES DEALER'S $4 MILLION PRICE DISCRIMINATION JUDGMENT

For the first time in over a decade, the Supreme Court in early 2006 addressed Robinson-Patman Act standards for price discrimination in Volvo Trucks North America, Inc. v. Reeder-Simco GMC, Inc., 2006 WL 43971 (U.S. Jan. 10, 2006). The decision came in the context of a dealership dispute. A key fact in this case was that Volvo Trucks North America, the defendant at trial, had, like many companies, decided to reduce its dealership ranks so that each dealer would serve a larger market. With that common backdrop, the plaintiff convinced a jury that Volvo Trucks had discriminated against the dealer in price in order to eliminate it as part of the reduction plan (which was called "Volvo Vision"), and a treble-damages judgment was entered at over $4 million, plus attorneys' fees. The Supreme Court's decision reversed that judgment and refused to expand price discrimination law.

When two buyers of a product compete against each other to resell the product, the Robinson-Patman Act can require the original seller to sell to both buyers at the same price. But the Supreme Court's recent decision clarifies that a buyer who pays more cannot prevail on a federal price discrimination claim unless it was competing head-to-head for resales to the same customer at the same time. Absent head-to-head competition, the disfavored buyer, like Reeder-Simco, cannot show the "injury to competition" required under the law. The decision also confirmed more generally that the antitrust laws do not bar a manufacturer from restructuring its distribution network to improve the efficiency of its operations. Therefore, the implementation of the "Volvo Vision" to have fewer, larger dealers did not cause the result to change.

Even though the manufacturer/seller ultimately won this case, the Supreme Court's opinion makes clear that sellers still need to follow the Robinson-Patman Act. First, the court refused to rule that price discrimination law never can come into play when the buyer is seeking a special price in order to make a competitive bid to an end-user. That defense had been raised both by Volvo Trucks and the United States government; both wanted the court to rule that the Robinson-Patman Act never applies in the competitive bid context, but the court sidestepped that point. Second, the court specifically mentioned that the plaintiff had not presented a "statistical analysis" to show that its sales or profits were diverted to a favored purchaser. The express reference to the absence of statistical analysis could imply that a verdict would be upheld if statistics prove the requisite injury. Third, the court stated once again that the purpose of federal price discrimination law is to protect smaller buyers from "large chain stores" who otherwise could get lower prices than could the smaller buyers. This sounds ominous to franchisors and manufacturers looking to sell products to large, multiple-store buyers at favorable prices, while also serving as warning to franchise "chains" that are buying product.

In the end, however, the Supreme Court also reaffirmed that preserving competition between brands remains more important than the regulation of any single brand's distribution network. Price discrimination law is being construed for now consistent with that broader antitrust policy of promoting interbrand competition.

FRANCHISE LAW APPLICABILITY

PRODUCT MARK-UP FOUND NOT TO BE A FRANCHISE FEE; EXCLUSIVE DISTRIBUTION RIGHTS DID NOT INCLUDE INTELLECTUAL PROPERTY

The United States District Court for the District of Minnesota recently denied a distributor's motion for a preliminary injunction, relying on two conclusions of law favorable to the manufacturer defendant. In Coyne's & Company v. Enesco, 2007 U.S. Dist LEXIS 79003 (D. Minn. Oct. 12, 2007), the plaintiff had been granted the exclusive rights to distribute the defendant's product line in the United States and Mexico, in exchange for a 50 percent markup on the products. Plaintiff sued for a preliminary injunction when it appeared the defendant would begin distributing its products in North America through a different party.

In support of its claim of irreparable harm (a necessary component of the injunction request), the plaintiff made two arguments: (1) that the Minnesota Franchise Act applied to its relationship with the defendant; and (2) the defendant's actions constituted infringement of plaintiff's exclusive right to use the trademarks and copyrights associated with the products. Irreparable harm is presumed under the Minnesota Franchise Act and in claims of copyright and trademark infringement. With relatively little analysis, the court found, however, that the 50 percent product markup did not constitute a franchise fee, but rather was an "ordinary business expense" for the distributor. Further, the court found no threatened copyright or trademark infringement, as the distribution agreement did not grant the plaintiff exclusive trademark or copyright rights. The court rejected the plaintiff's argument that its exclusive distribution rights necessarily included exclusivity to use the intellectual property associated with the products.

Since the plaintiff relied on the presumed irreparable harm that flows from a violation of the Minnesota Franchise Act or a copyright or trademark infringement, and since the court held that neither could be established as a matter of law, the preliminary injunction motion was denied for lack of irreparable harm. The court concluded that the plaintiff would have an adequate remedy by seeking money damages for breach of contract, if a breach could be proved.

BEVERAGE DISTRIBUTORSHIP NOT A "FRANCHISE" UNDER CONNECTICUT ACT

In B & E Juices, Inc. v. Energy Brands, Inc., Bus. Fran. Guide ¶13,748 (D. Conn. Oct. 26, 2007), a federal district court in Connecticut found that a beverage distributor was not a "franchisee" for purposes of the Connecticut Franchise Act. The plaintiff beverage distributor sought a preliminary injunction restraining the defendant manufacturer from terminating a distribution agreement between the parties. B & E asserted that it had a franchise relationship with Energy Brands and that under the Connecticut Franchise Act, a franchisor may only terminate a franchise for good cause. B & E argued that Energy Brands improperly terminated the distribution agreement after Energy Brands was acquired by another beverage manufacturer that sought to use its own extensive network of distributors to distribute the Energy Brands products.

In determining whether B & E was a franchisee under the Connecticut Franchise Act, the court applied a multi-factor test established to determine Energy Brands' level of control over B & E's marketing plan. The court found that Energy Brands did not control many of the aspects of B & E's marketing, including the hours and days of operation; Energy Brands did not require B & E employees to wear any particular uniform; Energy Brands was not involved in the hiring or firing of B & E employees; and there was no evidence the Energy Brands required any training of B & E employees. In addition, the court held that while Energy Brands controlled some of the pricing of its product to customers, there was a significant portion that it did not control. Further, among other things, the court held that a majority of B & E's trucks did not carry advertising for Energy Brands' products, that B & E was never required to provide the company with financial reports, and that Energy Brands' employees did not dictate how B & E must run its business. After weighing the facts, the court found that B & E did not engage in the offering, selling, or distributing of goods under a marketing plan prescribed in substantial part by Energy Brands.

Additionally, the court found that B & E's business was not "substantially associated" with Energy Brands' trademarks, trade names, or advertising. Despite the fact that Energy Brands products constituted 40% of B & E's business, the majority of B & E's business was derived from distributing Snapple products. The majority of B & E's trucks bore Snapple advertising and the majority of B & E's coolers were Snapple coolers. In fact, because of B & E's distribution agreement with Snapple, B & E could not distribute one of Energy Brands' products that competed with Snapple. As a result, the court determined that B & E was not completely dependent upon the public's confidence in the "franchised" product for most or all of its business.

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