GRAY PLANT MOOTY

The GPMemorandum

TO: **OUR FRANCHISE AND DISTRIBUTION CLIENTS AND FRIENDS**

FROM: **GRAY PLANT MOOTY'S FRANCHISE AND DISTRIBUTION PRACTICE GROUP**

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This issue of *The GPMemorandum* focuses on topics primarily of interest to companies that use distributors and dealers rather than manage a business format franchise system. The distribution-related topics this quarter include terminations, antitrust, and the application of state statutes.

TERMINATIONS

THIRD CIRCUIT AFFIRMS TERMINATION OF DEALER AGREEMENT WITHOUT CAUSE

The United States Court of Appeals for the Third Circuit has affirmed in part and reversed in part a Pennsylvania federal court's order dismissing a dealer's claims that arose from the alleged improper termination of its dealer agreement. *Bull Int'l, Inc. v. MTD Consumer Grp., Inc.*, 2016 WL 3542249 (3d Cir. June 29, 2016). MTD terminated, without cause, a termless dealer agreement with Bull in accordance with the express terms of the agreement. Bull claimed that, among other things, the termination breached the implied covenant of good faith and fair dealing because it was motivated by "improper and invidious" reasons – for instance, Bull's advocacy for dealer-friendly legislation. MTD moved to dismiss on the grounds that the parties' agreement expressly permitted termination without cause.

On appeal, the Third Circuit agreed with MTD and affirmed the district court's dismissal of Bull's good faith and fair dealing claim, observing that conduct in accord with express contractual rights cannot constitute a breach of the implied covenant. The court noted that even if, under the applicable law of Ohio, a claim for breach of the implied covenant may arise where the purported justification for the termination of a contract was pretextual, those circumstances did not exist in this case because MTD offered no justification at all for the termination and did not need to do so under the parties' agreement. The court further held that retroactive application of an Ohio law governing the termination of dealer agreements would violate the retroactivity clause of the Ohio Constitution, and that Bull's tortious interference claims were barred by Pennsylvania's "gist of the action" doctrine because they arose from conduct controlled by the express terms of the parties' agreement. Finally, the court agreed with the district court that Bull had not adequately pled a claim for breach of the implied warranty of fitness for a particular purpose, but disagreed that it had not adequately pled a claim for breach of the implied warranty of merchantability and, therefore, reversed the district court's dismissal of that claim.

DEALER FAILS TO STATE A CLAIM UNDER INDIANA FRANCHISE ACT BUT CAN PROCEED WITH UNFAIR PRACTICES CLAIM

Meanwhile, the United States District Court for the Northern District of Indiana granted in part and denied in part a manufacturer's motion to dismiss claims arising from the termination of a dealership agreement in *Ervin Equipment Inc. v. Wabash National Corp.*, 2016 WL 2892132 (N.D. Ind. May 17, 2016). Ervin entered into a dealership agreement with semitrailer manufacturer Wabash that granted Ervin the right to sell Wabash products in a territory that covered parts of Texas and all of Mexico. After several years, during which Ervin repeatedly sold Wabash products outside of its territory, prompting complaints from other Wabash dealers, Wabash gave Ervin notice of its intent to terminate the agreement. Ervin filed suit, alleging that Wabash violated the Indiana unfair practices statute and the Indiana Franchise Act ("IFA") by terminating the agreement without good cause.

The court first determined that Wabash granted Ervin a franchise within the meaning of the Indiana unfair practices statute because Ervin was a dealer that had the right to use Wabash's trademarks and trade names, and the parties shared a community of interest in the marketing of Wabash trailers. The court then denied Wabash's motion to dismiss Ervin's claim under that statute because questions of fact existed as to whether Wabash had good cause to terminate the parties' agreement and whether it provided sufficient notice to Ervin. Turning to Ervin's IFA claim, the court noted that in order to create a franchise relationship under the statute, the agreement at issue must require the use of a marketing plan prescribed in substantial part by the franchisor. Because the parties' agreement provided that Ervin controlled marketing decisions, the court concluded that Ervin had failed to sufficiently allege a claim under the IFA.

ANTITRUST

WATCH SUPPLIER IS NOT A FRANCHISOR BUT MAY HAVE PROVIDED PROMOTIONAL BENEFITS TO RETAILERS UNEQUALLY

The United States Court of Appeals for the Third Circuit recently ruled that Swatch Group was not subject to New Jersey's Franchise Practices Act ("NJFPA") but partially reversed the lower court's summary judgment order because a material dispute of fact remained regarding a retailer's claim that Swatch violated the Robinson-Patman Act ("RPA"). *Orologio of Short Hills, Inc. v. Swatch Group (U.S.), Inc.*, 2016 WL 3454211 (3d Cir. June 24, 2016). Orologio, a high-end watch store in suburban New Jersey, sued Swatch after it was dropped as an authorized dealer. Orologio claimed that the termination was without cause in violation of the NJFPA and that Swatch also violated the RPA by not providing certain promotional benefits to all of its authorized Omega dealers on "proportionally equal terms."

The Third Circuit rejected Orologio's state law claim on the grounds that the store was not a franchisee as defined by the NJFPA. According to the court, there was no "community of interest" because Orologio was not economically dependent on Swatch, and because there was insufficient evidence that Swatch exerted significant control over Orologio. On the store's RPA claim, however, the Third Circuit found sufficient evidence to reverse and remand. Orologio alleged that Swatch told some stores that they could access co-op advertising funds simply by applying for them, while telling others that the funds were awarded exclusively on the basis of sales benchmarks. The court held that further proceedings were needed to determine whether Swatch did in fact make those and other funds more readily available to some retailers than to others in violation of the RPA's "proportionally equal" requirement.

PREVENTATIVE MEASURES FOR MANUFACTURERS

In Issues 196 and 200 of *The GPMemorandum*, we discussed some of the common antitrust risks facing manufacturers. Prevention is the best cure for those problems, as attempts to address the risks at the time of termination or after a claim has been lodged are too late. We recommend that manufacturing companies review their compliance with antitrust laws by formally gathering and scrutinizing all of their pricing programs, sales policies, competitor communications, and customer agreements, among other documents, to uncover and defuse landmines. Sales leadership and other executives should be interviewed regarding their interactions with customers and, crucially, any competitors with which your company has contact. Top management should receive a report of this compliance review.

In addition, training should be provided to all involved. This can be accomplished through legal sessions presented at company-wide sales meetings, for example, and through online training modules that are made mandatory for all employees who deal with customers or competitors.

Finally, carefully drafting documents is a good way to avoid legal liability before terminations occur and claims arise. Having clear contracts, policies, and programs in place should avoid most disputes about termination, pricing, and resale controls. In the same vein, having clear documentation of what is and is not part of the relationships with competitors is crucial in avoiding collusion.

STATE FRANCHISE LAWS

SIXTH CIRCUIT AFFIRMS APPLICATION OF OHIO ALCOHOL DISTRIBUTOR PROTECTION LAW'S SUCCESSOR-MANUFACTURER EXCEPTION TO PARENT-LEVEL SALE

The United States Court of Appeals for the Sixth Circuit has affirmed a lower court's finding that the successor-manufacturer exception to Ohio's alcohol distributor protection law applies when termination follows the sale of an alcohol supplier's parent company to a third party. *Tri County Wholesale Distribs., Inc. v. Labatt USA Operating Co., LLC*, 2016 WL 3618970 (6th Cir. Mar. 17, 2016). Under ordinary circumstances, the Ohio statute requires a supplier to have "just cause" for termination of an alcohol distributor. There is, however, an exception to the just cause requirement when a successor manufacturer (*i.e.*, an entity assuming control of supply as a result of the acquisition of an alcohol supplier) terminates a pre-existing distributor. In *Tri County*, the distributor was terminated following the sale of the supplier's parent entity. Sale of the parent gave the purchaser control over the subsidiary alcohol supplier, even though the supplier entity itself continued to be owned by the same parent entity. The terminated distributor sued, arguing that the sale of the parent did not qualify for the successor-manufacturer exception because the company sold (the parent) was not the entity actually supplying alcohol to distributors. The district court rejected the distributor's "hyperliteral" reading of the statute and found that the post-sale termination qualified for the exception and did not require the supplier to have just cause for termination.

The Sixth Circuit affirmed, condoning the control-based approach applied by the district court. In reviewing analogous case law, the Sixth Circuit distinguished the sale from an intra-company restructuring, which would not qualify for the exception. Because the termination was an exercise of newly acquired control over the business decisions of the supplier, the just cause standard did not apply. The court also concluded that the exception was not an unconstitutional governmental taking because distributor protection was a statutory right that the state was free to take away.

COURT FINDS FRANCHISOR'S HAULING AGREEMENT IS NOT GOVERNED BY WISCONSIN FAIR DEALERSHIP LAW

A Wisconsin federal court recently granted summary judgment in favor of Dean Foods on the plaintiff's claim that a hauling agreement between the parties was governed by the Wisconsin Fair Dealership Law ("WFDL"). *Andrea Distrib., Inc. v. Dean Foods of Wis., LLC*, 2016 WL 3199544 (W.D. Wis. June 8, 2016). Dean Foods and Andrea Distributing were parties to two agreements: (1) a hauling agreement, under which Andrea Distributing hauled Dean Foods' products directly to Dean Foods' customers, and (2) a distribution agreement, under which Andrea Distributing purchased products from Dean Foods to resell to its own customers. Dean Foods terminated the hauling agreement when Andrea Distributing began to have financial difficulties and insisted on raising its hauling rates. A few months later, Dean Foods also terminated the distribution agreement when Andrea Distributing failed to cure a past-due balance. Andrea Distributing filed suit, claiming that both agreements were part of a unified distribution agreement and, therefore, had to be terminated in accordance with the WFDL, which requires 90 days' notice and good cause for termination. Dean Foods moved for summary judgment on the grounds that the agreements were separate and distinct and that only the distribution agreement was subject to the WFDL.

In granting the motion, the court held that the hauling agreement was not covered by the WFDL because the parties structured and treated the two agreements as separate components of their business relationship. The court further determined that the hauling agreement did not independently constitute a distribution agreement because it did not require Andrea Distributing to purchase equipment, build facilities, use Dean Foods' trademark, or make other substantial investments in the business. Because the hauling agreement did not create a dealership under the WFDL, the statute did not apply to its termination. With regard to the distribution agreement, the court concluded that Andrea Distributing's uncured past-due balance provided good cause for termination and that Dean Foods had complied with the WFDL.

DISTRIBUTOR NOT REQUIRED TO REPURCHASE MERCHANDISE UNDER STATUTORY BUY-BACK PROVISION

In *Miller Construction Equipment Sales, Inc. v. Clark Equipment Co.*, 2016 WL 2626803 (D. Alaska May 6, 2016), the federal court in Alaska found that a distributor did not have an obligation to repurchase several pieces of equipment in its former dealer's inventory under Alaska's distributorship statute. After the parties' distribution agreement ended, Miller demanded that Clark repurchase several pieces of heavy equipment (and associated attachments) under a statute which governs the disposition of a dealer's remaining merchandise upon the termination of a distributorship. In particular, the statute requires a distributor to repurchase only "unused" merchandise, or merchandise still in its original packaging or container. The heavy equipment at issue, however, was never in any packaging, and the Alaskan Supreme Court had not yet considered how the law applied in such a circumstance.

Miller filed suit and eventually moved for summary judgment, arguing that a prior contract between the parties and industry custom established that equipment used for less than 300 hours was "new" equipment and thus should be deemed "unused" under the Alaskan law. The court rejected that argument. Relying on the interpretation of similar distributorship statutes from other states, the court held that the term "unused," in situations where the merchandise was never in any packaging, meant merchandise that had not been "commercially used." It was undisputed that the three pieces of heavy equipment at issue were commercially used. Accordingly, the distributor had no obligation to repurchase them. The court further held, however, that the distributor did have an obligation under the same law to repurchase several attachments to the heavy equipment that were still in their original packaging.

POST-TERMINATION INJUNCTIONS: NONCOMPETE COVENANTS

DISTRIBUTOR PRELIMINARILY ENJOINED FROM VIOLATING NONCOMPETITION AND NONSOLICITATION AGREEMENTS

A federal district court in Washington has preliminarily enjoined a terminated distributor from violating the terms of his distribution agreement by competing with Organo, his former supplier of mushroom-based drinks and products. *Organo Gold Int'l, Inc. v. Ventura*, 2016 WL 1756636 (W.D. Wash. May 3, 2016). The parties' agreement included a noncompete provision that prohibited Ventura's participation in any opportunity involving the sale of mushroom-based products for twelve months following termination. The agreement further prohibited Ventura from soliciting or recruiting other distributors in Organo's network during that same time period. After Ventura's agreement was terminated, Organo filed suit and moved for a preliminary injunction, alleging that Ventura had approached other distributors in its network and attempted to recruit them to join a new business that offered mushroom-based products for sale.

The court first determined that the noncompete provisions in the distribution agreement were reasonable and necessary to protect Organo's business model, which relied heavily on its network of distributors and marketers. Next, the court held that Organo had shown a likelihood of succeeding on its breach of contract claims by presenting substantial evidence that Ventura solicited other distributors in its system to directly compete against it. Organo also established that it was likely to suffer irreparable harm given its continued loss of distributors. Finally, the court concluded that the balance of equities tipped in Organo's favor because Ventura could still work in the industry and that the injunction served the public's interest in the enforcement of reasonable and necessary noncompete agreements.

PRELIMINARY INJUNCTIONS

COURT PARTIALLY GRANTS TRUCK MANUFACTURER'S REQUEST FOR PRELIMINARY INJUNCTION

A Virginia federal court partially granted Volvo Group North America's motion for a preliminary injunction to stop the proposed sale of a group of truck dealerships. *Volvo Grp. N. Am., LLC v. Truck Enters., Inc.*, 2016 WL 1479687 (W.D. Va. Apr. 14, 2016). Volvo initiated the suit against a group of truck dealers who owned and operated seven dealerships, four of which sold both Volvo and Kenworth trucks, two of which sold Kenworth and Isuzu trucks, and one that sold only Kenworth trucks. The dealers entered into an agreement with a third party to sell the dealerships in a package deal. In response, Volvo filed a complaint alleging, among other things, that the proposed sale frustrated Volvo's contractual and statutory rights of first refusal. Volvo also filed a motion for preliminary injunction requesting that the court (1) stop the sale until the scope of Volvo's rights could be determined, and (2) require the dealers to disclose the terms of the sale that were specific to the Volvo portions of the "dualed dealerships" so that Volvo could determine whether to exercise its right of first refusal. The dealers opposed the motion and argued that Volvo could not purchase only the Volvo portions of the dealerships and instead had to take the place of the third-party buyer and purchase all or none of the dealerships.

The court held that Volvo was entitled to an injunction staying the proposed sale pending the outcome of the litigation. In doing so, the court explained that the holder of a right of first refusal cannot be forced to purchase more than what is contractually agreed to, and highlighted that the Volvo dealer agreements specifically contemplated that only Volvo assets would be subject to the right of first refusal. However, the court denied Volvo's request to require the dealers to provide information related to the value of the Volvo portions of the "dualed dealerships." The court determined that because it had enjoined the proposed sale pending the outcome of the litigation, Volvo would not suffer any harm from not immediately receiving the financial information.

Along with the attorneys indicated on the next page, summer associates Robert Gallup, Dion Farganis, Olivia Garber, Amanda McAllister, and Cade Cross all contributed to this issue.

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