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 antitrust, the application of state statutes, and post-termination injunctions.

ANTITRUST – PRICE DISCRIMINATION

DEALER PRICE DISCRIMINATION CLAIM DISMISSED

A federal court in Iowa last week dismissed with prejudice a dealer's price discrimination claim made under the Robinson Patman Act ("RPA"). *Sioux City Truck & Trailer, Inc. v. Ziegler, Inc.*, No. 16-cv-4106 (N.D. Iowa Dec. 5, 2016). Gray Plant Mooty represented the supplier in this case. The dealer had been party to an engine parts and service agreement, which was terminated by the supplier, Ziegler, earlier this year. Ziegler tendered a new contract that would have allowed Sioux City Truck & Trailer ("SCTT") to buy parts, but not to be a "full service" dealer. SCTT refused to sign the new agreement and sued on the theory that the cost of parts would be higher under the new contract than what it had paid as a full service dealer, and presumably higher than what other full service dealers paid. SCTT never bought any parts from Ziegler after the old contract was terminated.

In granting dismissal of the price discrimination claim, the court noted that the RPA prohibits sales to different customers at different prices; an offer to

sell to one customer at a higher price does not count. The court rejected all of SCTT's arguments and authorities for exceptions to the "two purchaser" rule. Accordingly, because Ziegler merely proposed the new contract and the presumably higher prices, SCTT could not meet the statutory requirements for a cause of action. The court did not even need to address the other requirements of a federal price discrimination claim.

MANUFACTURER MAY LIMIT SALES OF LARGE-PACK GOODS TO DISCOUNT CHAINS WITHOUT COMMITTING PRICE DISCRIMINATION

A manufacturer can sell its largest packs of products only to discount club chains without engaging in illegal price discrimination, according to the United States Court of Appeals for the Seventh Circuit in *Woodman's Food Market, Inc. v. Clorox Co.*, 833 F.3d 743 (7th Cir. 2016). The case concerned Clorox's practice of selling its largest-sized containers of products only to discount warehouses such as Sam's Club or Costco. Woodman's, a small grocery chain based in Wisconsin and Illinois, sued Clorox seeking injunctive relief for unlawful price discrimination under Section 13(e) of the RPA, which forbids any manufacturer from "discriminat[ing] in favor of one purchaser against another purchaser," by furnishing "services or facilities" not available to all purchasers.

Woodman's argued that packaging size is a type of promotional service because (1) large packs tend to have a lower per-unit cost than smaller packs, and (2) large packs provide the customer with the added convenience of having to shop less frequently. The Seventh Circuit found the first argument unpersuasive, holding that the subsection of the RPA at issue only prohibited the provision of advertising perks to purchasers as a way around the statute's prohibition on price discrimination. The court also rejected the second argument, finding that the RPA only addresses "promotional" services or facilities, rather than any product attribute a customer might find appealing, such as fewer trips to the store. The court also noted that according to the Federal Trade Commission's current guidance, the RPA prohibits only "promotional" services or facilities used primarily to promote the *resale* of the manufacturer's product to the consumer, as opposed to the original sale from the manufacturer to the purchaser.

OHIO FEDERAL COURT DENIES DISMISSAL OF PRICE DISCRIMINATION CLAIM

Meanwhile, the United States District Court for the Northern District of Ohio denied a car distributor's motion to dismiss a claim under the RPA. *Bedford Nissan, Inc. v. Nissan N. Am., Inc.*, 2016 WL 6395799 (N.D. Ohio Oct. 28, 2016). After discovering that Nissan North America had given Bernie Moreno, a dealer, cash and sales incentives not offered to all dealers in the area, four other Nissan dealers in the same market sued Nissan, claiming, among other things, that the incentive payments allowed Moreno to purchase and sell Nissan vehicles at substantially lower prices than the plaintiffs.

The court held that the plaintiffs had sufficiently alleged the elements of a claim under the RPA. To succeed on the claim, a plaintiff must show that 1) the sales were made in interstate commerce, 2) the products sold were of like grade and quality, 3) the seller discriminated in price between the purchasers, and 4) the effect of the discrimination may be to injure competition. The court found there was no question that the first two requirements were met and rejected Nissan's argument that the third requirement was lacking because it did not sell vehicles to Moreno and the plaintiffs at different prices. The court explained that price discrimination can be shown indirectly when one buyer receives something of value (in this case, incentive payments) not offered to other buyers. Finally, the court found that the fourth element was satisfied because an inference could be drawn that a competitor receiving incentive payments over a substantial period of time would cause intra-brand competitive injury.

FUNCTIONAL AVAILABILITY DEFENSE BARS DEALER'S PRICE DISCRIMINATION CLAIMS

Another federal court in Ohio dismissed price discrimination claims brought against a motor vehicle manufacturer after ruling that the "functional availability" defense barred the claims. *Brentlinger Enters. v. Volvo Cars of N. Am.*, 2016 WL 4480343 (S.D. Ohio, Aug. 25, 2016). Brentlinger, a Volvo dealer, sued Volvo over a tier-based incentive program that provided dealerships that only carried Volvo products and met Volvo's design standards with higher bonuses per vehicle sold and a larger allocation of high demand vehicles than it did to stores that did not meet both criteria. Brentlinger did not meet both criteria and did not receive the maximum incentive payments under the program. Brentlinger sued alleging, among other claims, that the incentive program constituted price discrimination under two provisions of the Ohio Motor Vehicle Franchise Act and the RPA. On cross motions for summary judgment, the court addressed the question of whether the "functional availability" defense could be asserted by Volvo against all of Brentlinger's price discrimination claims.

The "functional availability" defense allows a manufacturer to avoid price discrimination liability if the manufacturer can show that the lower price was, in fact, reasonably available to the aggrieved party. After examining the history and purpose of the functional availability defense, the court ruled that it could be asserted in response to all of Brentlinger's price discrimination claims. The court reasoned that under Ohio law, a plaintiff must show that its damages are proximately caused by the violation of the specific statutory provision at issue, and regardless of the language of the statutory provision itself, the functional availability defense served as an attack on the element of proximate cause. The court then determined that the functional availability defense compelled the dismissal of Brentlinger's price discrimination claims. Brentlinger argued that the incentive program was not reasonably available because the eligibility criteria for the maximum payments under the program were too expensive to achieve, and

local zoning laws made it impossible for Brentlinger to comply with Volvo's design standards. The court held that these arguments did not overcome the functional availability defense, noting that it was the dealer's choice whether to undertake the renovation and receive the corresponding benefit, and there was no evidence that Brentlinger even asked for a zoning variance to meet the design criteria.

ANTITRUST – TYING

THIRD CIRCUIT REVERSES DEALER'S VERDICT AGAINST TELECOM EQUIPMENT MANUFACTURER

The United States Court of Appeals for the Third Circuit recently reversed a large antitrust jury verdict that had been entered against telecom equipment manufacturer Avaya. *Avaya Inc. v. Telecom Labs, Inc.*, 838 F.3d 354 (3d Cir. Sept. 30, 2016). After a lengthy and contentious trial, a jury had awarded a $20 million general verdict in favor of Telecom Labs, a former Avaya dealer and maintenance provider, finding that Avaya had attempted to monopolize the aftermarket for maintenance of its specialized telephone switchboard for business organizations and had unlawfully tied software patches to its predictive dialing system. In the middle of trial, the district court dismissed Avaya's own claims against the dealer for breach of contract.

The Third Circuit first ruled that the decision to dismiss Avaya's contract claim was not only erroneous, but also cast doubt on the correctness of the ultimate verdict. Avaya had alleged that Telecom Labs breached a contractual agreement to not compete intra-brand by marketing its maintenance services to existing Avaya customers. Because Avaya introduced evidence supporting its claim, the court determined that it should have gone before the jury. The Third Circuit also reversed the attempted monopolization verdict against Avaya. Although there was strong competition in the primary market for Avaya's switchboard system from companies like Cisco, Siemens, and Microsoft, Telecom Labs had argued that Avaya locked its customers in after purchasing such a system by requiring maintenance only from Avaya or its approved service providers. The Third Circuit found that, at least after 2008, all purchasers of Avaya's system were on notice of this contractual requirement at the time of sale, and that Avaya's practices did not constitute an unlawful restraint of a competitive market. The court concluded that evidence of exclusionary and predatory conduct before 2008 could be submitted to the jury, but the lawfulness of that conduct had to be weighed against Avaya's defense that it was specifically combating its dealer's own tortious behavior and breaches of contract.

Finally, the court reversed and dismissed the claim that Avaya had unlawfully tied software patches to its predictive dialing system by threatening to withhold the patches from customers who dealt with Telecom Labs instead of other approved maintenance

providers. The court noted that such threats may have been a frustration to Telecom Labs, but evidence of a strongly worded letter was insufficient to expand the reach of tying liability.

NINTH CIRCUIT AFFIRMS THAT MANUFACTURER OF EQUIPMENT DID NOT ENGAGE IN ANTICOMPETITIVE PRACTICES IN REPAIR MARKET

The United States Court of Appeals for the Ninth Circuit has affirmed a district court holding that Aerotec International failed to establish federal antitrust claims against Honeywell International, one of the largest manufacturers of auxiliary power units for aircraft. *Aerotec Int'l v. Honeywell Int'l*, 836 F.3d 1171 (9th Cir. 2016). Aerotec, a small company that provides repair services for Honeywell's products, alleged that during a worldwide parts shortage, it was unable to purchase from Honeywell the parts necessary to service its clients because Honeywell's part allocation system assigned independent companies like Aerotec a lower priority than Honeywell affiliates. The Ninth Circuit affirmed the lower court's grant of summary judgment in favor of Honeywell, holding that Aerotec's claims failed as a matter of law and that Aerotec had failed to present sufficient evidence to support its claims.

The Ninth Circuit held that Honeywell did not engage in prohibited tying because it found no evidence that Honeywell conditioned the sale of replacement parts on the requirement that purchasers use Honeywell for repair services, either explicitly or by implication. The court also rejected Aerotec's arguments that Honeywell's policies disfavoring independent companies were a form of "de facto" tying and that Honeywell engaged in exclusive dealing with customers in violation of the Sherman Act. Although nearly half of Honeywell-manufactured airplane equipment was under some type of repair contract with Honeywell, Aerotec did not proffer any specific details of those contracts that would establish its claim of exclusive dealing.

In addition, the Ninth Circuit found no evidence of Honeywell's alleged unlawful "refusal to deal," noting that evidence of ill intent is not sufficient to violate antitrust laws because such laws are intended to regulate "anticompetitive conduct, not merely anticompetitive aspirations." The court also dismissed Aerotec's claim that Honeywell had violated the "essential facilities" doctrine, which imposes liability when a party with market power denies competitors access to an item deemed essential to competition. Noting that the United States Supreme Court has yet to recognize the doctrine, the court held that the replacement parts Honeywell allocated to its affiliates over Aerotec were not "essential" because substitute parts could be purchased elsewhere. Further, the court dismissed Aerotec's claims of unlawful bundling, noting that Aerotec and other companies had the ability to offer similar bundles, and found that Honeywell did not offer repair services below its cost because the prices were part of a long-term agreement on which Honeywell turned a profit.

STATE FRANCHISE LAWS

FIRST CIRCUIT AFFIRMS DECISION FINDING THAT CLAIMS BASED ON ALLEGED EXCLUSIVE DISTRIBUTOR ARRANGEMENT WERE TIME BARRED

The United States Court of Appeals for the First Circuit partially affirmed a lower court's decision that a product distributor's claims based on an allegedly exclusive distribution agreement were barred by the three-year statute of limitations under Puerto Rico's Dealers Act ("Law 75"). *Medina & Medina Inc. v. Hormel Foods Corp.*, 840 F.3d 26 (1st Cir. 2016). Medina, the distributor, entered into a verbal distribution arrangement with Hormel in 1988, which Medina alleged gave it the exclusive right to distribute Hormel's retail refrigerated products in Puerto Rico. Beginning in 1990, Medina began to complain that stateside distributors were purchasing and distributing Hormel's retail refrigerated products in Puerto Rico in violation of the parties' exclusive arrangement. Over the course of twenty years, Medina repeatedly demanded that Hormel stop these mainland distributors. Medina finally filed suit in 2009 when Costco (which had previously purchased Hormel products from Medina) began purchasing party platters directly from Hormel at a lower price and shipping the products from the mainland to its stores in Puerto Rico. The district court held that Medina's claims were largely barred by Law 75's three-year statute of limitations but allowed the claims concerning the resale of party platters by Costco to proceed. Both parties appealed.

The First Circuit affirmed in part and reversed in part the district court's decision. The appellate court observed that, from the beginning of the parties' relationship, Medina knew that Hormel was selling its products to mainland distributors for ultimate resale in Puerto Rico and that Hormel did not consider the relationship an exclusive one. Because Medina failed to sue within the limitations period, the First Circuit affirmed the district court's conclusion that Medina's exclusivity claims under Law 75 were time barred. The First Circuit also overturned the district court's finding that the 2009 retail sales by Costco survived Law 75's statute of limitations, since they were based on the same time-barred claim of territorial exclusivity.

DUTY OF GOOD FAITH AND FAIR DEALING

AUTO DEALER STATES GOOD FAITH AND FAIR DEALING CLAIM

The United States District Court for the Eastern District of New York concluded that an automobile dealer stated a plausible claim for breach of the implied covenant of good faith and fair dealing against its distributor in *Valley Stream Foreign Cars, Inc. v. American Honda Motor Co.*, 2016 WL 5239645 (E.D.N.Y. Sept. 22, 2016). Valley Stream alleged that American Honda's failure to enforce its wholesaling policy prevented Valley Stream from exercising its right to earn profits from the sale of Honda vehicles. Valley Stream

further alleged that American Honda received reports of wholesaling but chose to ignore them. In rejecting American Honda's argument that Valley Stream was seeking a strict enforcement of the wholesaling policy against all dealers, the court found that Valley Stream had adequately alleged that American Honda had "arbitrarily acted counter to its stated interest and the interest of its dealers by taking no steps to enforce its Wholesaling Policy." The court held that those allegations, taken as true, amounted to a practice in which American Honda "continu[ed] to turn a blind eye" to the policy, and did state a claim for breach of the implied covenant of good faith and fair dealing.

POST-TERMINATION INJUNCTIONS: NONCOMPETE COVENANTS

APPELLATE COURT UPHOLDS PERMANENT INJUNCTION PROHIBITING ENFORCEMENT OF U-HAUL'S COVENANT AGAINST COMPETITION IN CALIFORNIA

A California court of appeal recently affirmed a trial court's award of more than $800,000 in attorneys' fees under the state's Unfair Competition Law ("UCL") and the issuance of a permanent injunction against U-Haul prohibiting the company from enforcing a covenant against competition in its standard form contract with dealers in the state. *Robinson v. U-Haul Co. of Cal.*, 209 Cal. Rptr. 3d 81 (Cal. Ct. App. 2016). After Robinson terminated the parties' dealer contract and began renting trucks from a competitor, U-Haul sued for breach of the contract's covenant against competition, which purported to prevent Robinson from competing with U-Haul for up to two years following termination. Robinson sought a declaration that the covenant was void under California law and also filed a separate action against U-Haul raising claims for malicious prosecution and violation of the UCL.

Following the trial court's denial of its motion for a preliminary injunction to enforce the noncompete provision, U-Haul dismissed its complaint and maintained that Robinson's lawsuit was moot on the grounds that the company had voluntarily ceased its enforcement of the noncompete in California. The trial court rejected U-Haul's position, held that the noncompetition clause was void and unenforceable as a matter of law, and permanently enjoined U-Haul from further enforcement of the covenant in the state. The court of appeal affirmed, observing that the covenant at issue was illegal under California law and that U-Haul had nonetheless adopted a corporate practice of aggressively enforcing that provision through litigation and threats of litigation. Furthermore, the court of appeal agreed with the trial court's finding that U-Haul's insertion of the words "void where prohibited" into the language of the noncompete provision was insufficient to prove that U-Haul had corrected its anticompetitive behavior, and that U-Haul had not properly notified its current dealers that it did not intend to enforce the noncompete provision in California going forward. The appellate court also upheld the trial court's award of attorneys' fees to Robinson on his UCL claim under the private attorney general doctrine.

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