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 the application of state statutes, trademark ownership, and class actions.

STATE FRANCHISE LAWS

SIXTH CIRCUIT FINDS OWNERSHIP CHANGE PROVISION IN FRANCHISE AGREEMENT CONSISTENT WITH OHIO LAW

The United States Court of Appeals for the Sixth Circuit has reversed a district court’s grant of a preliminary injunction enjoining termination of a beer distributor who failed to obtain the brewer’s consent before a change of the distributor’s ownership. S. Glazer’s Dists. of Ohio, LLC v. Great Lakes Brewing Co., 860 F.3d 844 (6th Cir. June 26, 2017). The parties’ agreement required the brewer’s written consent prior to any change in ownership of the distributor. Yet, without obtaining consent, the distributor merged with another distributor and requested consent only after a dispute arose. In its motion to enjoin the termination, the distributor argued that the Ohio Alcoholic Beverages Franchise Act distinguishes between the transfer of a franchise and a transfer of ownership interests in the business itself, and by requiring consent only to the transfer of a “franchise,” the Act seeks to give distributors free reign to transfer their businesses. The district court agreed, relying largely on a decision issued earlier in a similar case.
The Sixth Circuit reversed, finding that the brewer did not violate the “essence” of the Ohio Alcoholic Beverages Franchise Act, which requires suppliers to exercise “good faith” and “reasonable standards for fair dealing,” which were not impermissibly waived by the parties’ agreement. The Sixth Circuit distinguished the case on which the distributor and the district court had relied, in which there had been no written agreement. Because the consent provision of the agreement at issue was consistent with Ohio law, the Sixth Circuit found that the distributor was unlikely to succeed on the merits. Further, the Sixth Circuit agreed that the potential harm to the distributor from termination was not irreparable because the contract’s liquidated damages provision would provide adequate compensation to the distributor. Recognizing the public interest in enforcement of private contracts, the Sixth Circuit overturned the preliminary injunction and remanded for further proceedings.

TRADEMARKS

THIRD CIRCUIT CLARIFIES TEST TO ESTABLISH TRADEMARK OWNERSHIP IN DISPUTES BETWEEN MANUFACTURERS AND DISTRIBUTORS

The United States Court of Appeals for the Third Circuit affirmed on alternative grounds the Western District of Pennsylvania’s finding that a manufacturer owned a trademark used to distribute its products, but the court vacated and remanded the case as to damages. Coverttech Fabricating, Inc. v. TVM Building Prods., Inc., 855 F.3d 163 (3d Cir. Apr. 18, 2017). Coverttech manufactures insulation products under the umbrella of its rFOIL brand, which includes the products CONCRETE BARRIER (a registered trademark) and ULTRA (an unregistered trademark). Coverttech entered into two agreements with TVM Building Products that designated TVM as the exclusive distributor of Coverttech’s rFOIL products and prohibited TVM from selling competitive products. After TVM sold comparable products manufactured by a competitor, Coverttech terminated its relationship with TVM. Nonetheless, TVM continued to sell under the rFOIL brand names, and Coverttech demanded that TVM cease using its trademarks. When TVM responded by registering the ULTRA trademark in its name, Coverttech filed an adverse petition with the Patent and Trademark Office seeking registration of ULTRA in its own name and also filed suit against TVM. The district court determined that Coverttech was the owner of the ULTRA trademark based on the “first use test,” which determines ownership by asking which party first used the unregistered trademark in commerce.

On appeal, the Third Circuit held that although the “first use test” is generally proper for determining ownership of unregistered trademarks absent a contractual arrangement, the district court should have used a test that accounted for the realities of the manufacturer-distributor relationship. Under this alternative test, the manufacturer is the presumptive trademark owner unless the distributor rebuts that presumption using considerations such as which party invented the mark, which party
first affixed the mark to goods and displayed its name on packaging, to which party did customers look as standing behind the goods, and which party paid for advertising and promotion. Applying this test, the appellate court still found in favor of Coverttech. The court did, however, remand the case to determine a more accurate damages award relating to TVM’s infringement of the rFOIL and CONCRETE BARRIER trademarks.

EXPERT TESTIMONY

COURT DENIES MOTION TO EXCLUDE EXPERT TESTIMONY ON LOST PROFITS

A federal court in South Dakota recently denied a motion to exclude a dealer’s expert testimony in a dispute over lost profits resulting from the termination of a distributor agreement. Black Hills Truck & Trailer, Inc. v. Mac Trailer Mfg., Inc., 2014 WL 5782452 (D.S.D. July 10, 2017). MAC had entered into a written distributor agreement with Black Hills. Less than a year later, MAC sent Black Hills proposed modifications to the agreement and required Black Hills to accept the modifications. Black Hills filed a lawsuit in response, alleging that MAC’s actions constituted a wrongful termination. MAC and joined defendant Siouxland later moved to exclude the testimony of an expert Black Hills had retained to testify as to its lost profits resulting from the termination.

In support of their position, MAC and Siouxland took issue with: (1) the original data applied to the expert’s formula for lost profits; (2) the expert’s “blind trust” in Black Hills’ representations; and (3) the expert’s “utterly unreliable” methodology. The court disagreed with all three arguments. The court found that factual objections to the original data were better addressed during cross-examination. Additionally, the court acknowledged that Black Hills was in the best position to provide the expert with the necessary factual information. Further, the court held that the expert’s method of subtracting variable expenses from gross profits was a proper methodology commonly seen in calculating lost profits. Finally, and importantly, the court recognized that it was impossible to create a forecast without some degree of speculation. Therefore, the court used its wide discretion to allow the expert testimony, finding that the benefit to the jury of the testimony was far more probative than prejudicial.

FRAUD

DEALER FAILS TO STATE FRAUDULENT CONCEALMENT CLAIM AGAINST MANUFACTURER SEEKING TO OPEN NEW LOCATION

A federal court in Colorado dismissed a car dealer’s claim of fraudulent concealment against its manufacturer in European Motorcars of Littleton, Inc. v. Mercedes-Benz USA, LLC, 2017 WL 2629133 (D. Colo. June 19, 2017). The controversy arose when Mercedes-Benz USA (“MBUSA”) entered into an agreement to establish a new
dealership several miles from plaintiff Mercedes-Benz of Littleton ("MBOL"). MBOL contended MBUSA had hid its intention to establish a new dealership nearby. The court dismissed the claim, holding that MBUSA had no duty to disclose its intention.

Applying Colorado law, the court observed that in the absence of a prior representation requiring correction, a duty to disclose arises only when a dealer has placed trust or confidence in the manufacturer beyond that which is typical of such a relationship, or when the dealer could have reasonably expected disclosure based on objective circumstances. MBOL contended that it had placed trust in MBUSA by investing in upgrades to its facilities. However, the court concluded that this action was insufficient to meet MBOL’s burden to show that it had placed trust and confidence in MBUSA beyond that inherent in every manufacturer/dealer relationship. Furthermore, the court determined that MBUSA took steps, through its contract language, to discourage MBOL from expecting open disclosure. For example, the parties’ dealer agreement permitted MBUSA to establish a new dealership at any time. Thus, MBOL had not adequately alleged that objective circumstances created a reasonable expectation of disclosure.

DUTY OF GOOD FAITH AND FAIR DEALING

CLAIM FOR BREACH OF IMPLIED DUTY OF GOOD FAITH AND FAIR DEALING ARISING OUT OF TERMINATION ALLOWED TO PROCEED

A federal court in Nevada declined to dismiss a beer distributor’s claim that a brewer had breached the implied duty of good faith and fair dealing in Crown Beverages, Inc. v. Sierra Nevada Brewing Co., 2017 WL 1508486 (D. Nev. Apr. 26, 2017). Plaintiff distributor Crown sued brewer Sierra Nevada Brewing over a dispute arising out of the parties’ distribution agreement that made Crown the exclusive importer and wholesaler of Sierra Nevada products in northern Nevada. Nevada statutes governing liquor suppliers and wholesalers require that a brewer notify a distributor 90 days before terminating an agreement, establish good cause, and provide a 60-day cure period in which the distributor may correct the deficiency. In October 2016, Sierra Nevada sent Crown a letter indicating that it wished to terminate the business relationship due to Crown’s alleged “harassment and bullying” of Sierra Nevada’s employees. Crown filed suit alleging that Sierra Nevada had violated the statute by attempting to terminate the relationship without good cause and without providing the required notice and cure periods. In November 2016, Sierra Nevada sent a second letter that articulated grounds for the termination and provided the mandatory 60- and 90-day notice and cure periods. The parties later met to discuss Crown’s proposal for curing the defaults cited by Sierra Nevada, but Sierra Nevada rejected the cure plan as inadequate.

Crown brought several claims, some of which the court dismissed as duplicative. However, the court allowed the good faith and fair dealing claim to proceed, finding
that: (1) Crown’s allegation that Sierra Nevada had “unreasonably” rejected its cure plan was sufficient to support a claim; (2) tort liability for breach of the covenant of good faith and fair dealing existed under Nevada law in “rare and exceptional” situations, such as in a franchise relationship where one party is in a superior position; (3) the relationship between a brewer and a distributor is one such situation; and (4) Crown’s allegations could support its claim that Sierra Nevada’s misconduct could be “grievous and perfidious,” which ultimately would be a question of fact.

CLASS ACTIONS

COURT DENIES CLASS CERTIFICATION IN PRICE DISCRIMINATION CASE AGAINST THE MAKER OF 5-HOUR ENERGY

A California federal court has denied class certification to two proposed classes of small wholesalers alleging that Living Essentials, LLC, the maker of 5-hour Energy, engaged in price discrimination. *ABC Distrib., Inc. v. Living Essentials LLC*, 2017 WL 2603311 (N.D. Cal. Apr. 7, 2017). The plaintiffs, who were three small wholesale distribution companies in California, alleged that Living Essentials sold 5-Hour Energy to wholesalers at different prices, discriminating against small wholesalers in violation of the Robinson-Patman Act and California law. The court found that, while the plaintiffs satisfied the requirement of numerosity under Federal Rule of Civil Procedure 23(a)(1), the articulated classes could not satisfy the other 23(a) requirements, which include common questions of law or fact, typicality, and adequacy of representation.

In particular, the court noted that a “Robinson-Patman case is not well suited for class certification because its analysis is singularly individualistic.” If the matter went to trial, each plaintiff would have to prove that its inventory was sold in interstate commerce, that the customers who were sold 5-Hour Energy were of “like grade and quality,” that the defendant discriminated in price between the plaintiffs and other purchasers of 5-Hour Energy, and that the effects of said discrimination “may be . . . to injure, destroy, or prevent competition.” Each plaintiff would also have to individually prove that it was in competition with the favored purchaser of 5-Hour Energy, Costco. While there was evidence that Living Essentials treated categories of wholesalers differently, and that Costco was receiving a price advantage, that evidence could not cure the underlying problem with the proposed classes: that the elements of succeeding on the claims were so individualistic. Although the court denied certification, the named plaintiffs were permitted to proceed with their claims.

Along with the attorneys indicated on the next page, summer associates Chelsey Enderle, Amy Fiecke, Hannah Holloran, Hannah Shirey, Abby Swanson Garney, and Maria de Sam Lazaro contributed to this issue.
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