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 arbitration, good faith and fair dealing, and antitrust.

ARBITRATION

SUPREME COURT BARS COURTS FROM DECIDING "WHOLLY GROUNDLESS" CLAIMS OF ARBITRABILITY

The Supreme Court has resolved a split in the federal circuit courts of appeals, holding that the Federal Arbitration Act does not allow a federal court to deny a motion to compel arbitration on the basis that the claim of arbitrability is "wholly groundless." *Henry Schein, Inc. v. Archer & White Sales, Inc.*, 139 S. Ct. 524 (2019). Archer and White, a dental equipment distributor, sued an equipment manufacturer and Henry Schein, Inc. for various remedies including injunctive relief. Archer and White's distribution agreement provided that "[a]ny dispute arising under or related to this Agreement (except for actions seeking injunctive relief and disputes related to trademarks, trade secrets, or other intellectual property of [Schein]), shall be resolved by binding arbitration in accordance with the arbitration rules of the American Arbitration Association." The AAA's rules require that questions of arbitrability be decided by the arbitrator. Schein moved to compel arbitration, and Archer and White responded that the motion should be denied as "wholly groundless."

The district court and the Fifth Circuit agreed with Archer and White. In vacating that decision, the Supreme Court observed that the FAA allows parties to agree that an arbitrator will resolve threshold arbitrability questions. The Court found that the parties had delegated that authority to the arbitrator in this case by choosing the AAA's rules. Although a court has the authority to determine whether parties have entered into a valid arbitration agreement, the Supreme Court held that a district court may not override a valid agreement that delegates to the arbitrator the authority to decide arbitrability — even if the court would find the claim of arbitrability to be "wholly groundless." Rather, the Court concluded, a "wholly groundless" exception to the FAA would be inconsistent with the Act and with Supreme Court precedent.

The Court's unanimous decision makes no mention of the similar "manifest disregard of the law" doctrine that has been entertained by some federal circuits in connection with motions to vacate final awards rendered in arbitration. Nevertheless, the reasoning of this decision does not bode well for the future viability of the "manifest disregard of the law" doctrine.

GOOD FAITH AND FAIR DEALING

SIXTH CIRCUIT HOLDS MEDICAL DEVICE MANUFACTURER DID NOT BREACH DISTRIBUTOR AGREEMENT OR IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING

The U.S. Court of Appeals for the Sixth Circuit recently affirmed summary judgment for a medical device manufacturer, Wright Medical Technology, on claims brought by a distributor, Beijing Fito Medical, alleging that Wright breached the distribution agreement between the parties. *Beijing Fito Med. Co. v. Wright Med. Tech., Inc.*, 2019 WL 480410 (6th Cir. Feb. 7, 2019). Wright and Fito entered into an agreement that gave Fito the right to serve as Wright's exclusive distributor of hip, knee, foot, ankle, and biologics products in China. The agreement permitted Wright to remove individual products from the contract as long as it gave 90 days' notice to Fito. The agreement also allowed Wright to assign any part of the agreement to a third party. Shortly after entering into the agreement with Fito, Wright entered into a "logistics" agreement with Shanghai CIIC, under which Shanghai became Wright's exclusive distributor of foot, ankle, and biologics products in China and Fito was permitted to purchase those products from Shanghai. A few months later, Wright advised Fito that it was selling a portion of its business, including its agreement with Fito, to a third party named MicroPort, and removing the foot, ankle, and biologic products from Fito's agreement. Fito filed suit against Wright in federal court in Tennessee alleging, among other things, that Wright breached the agreement and the implied covenant of good faith and fair dealing by (1) divesting Fito of its right to sell foot, ankle, and biologics products under the agreement, and (2) granting Shanghai "logistic" distributorship rights for those products. Wright successfully moved for summary judgment on Fito's claims.

On appeal, the Sixth Circuit confirmed Wright's summary judgment award. Because the agreement gave Wright broad discretion to remove products from Fito's distributor rights, it did not breach the agreement by doing so. Similarly, the court concluded that removing the foot, ankle, and biologics products did not breach the implied covenant of good faith and fair dealing under Tennessee law because Wright acted in accordance with the express provisions of the agreement and there was no evidence that it acted in bad faith or with the intent to harm Fito's business. Further, the appellate court held that because Fito retained the right to distribute other Wright products, removal of the foot, ankle, and biologics products did not result in termination in violation of the agreement. Finally, the court considered Fito's claim that Wright breached the "exclusivity" provision of the agreement or the implied covenant of good faith and fair dealing simply by entering into the "logistics" distribution agreement with Shanghai. It reasoned that Fito lost its right to distribute Wright's foot, ankle, and biologics products 90 days after receiving notice from Wright, and Shanghai had not distributed Wright's products before that date. Thus, Fito could not have suffered any damages from Shanghai's sale of products and, because Fito could not show damages, its claims would fail.

DISCRIMINATION

SIXTH CIRCUIT AFFIRMS SUMMARY JUDGMENT DISMISSING DEALER'S DISCRIMINATION CLAIMS

In another decision, the Sixth Circuit again affirmed summary judgment in favor of a manufacturer, this time on a dealer's claims that the manufacturer improperly terminated its distribution agreement. *B & S Transp., Inc. v. Bridgestone Ams. Tire Operation, LLC*, 2019 WL 581565 (6th Cir. Feb. 13, 2019). The claims arose after Bridgestone terminated its dealership agreement with B & S Transportation, an African-American owned and operated dealer of Firestone tires. The dealership agreement allowed B & S to pursue minority set-aside businesses and, as a result, had unique terms that other dealership agreements did not. For example, B & S was not required to maintain a retail location or provide any service or warranty work, such as repair, retreading, or other vehicle services. Bridgestone terminated the dealership agreement in 2013 because it had changed its "distribution and go to market solutions strategies" to emphasize a service-based model and B & S declined to make those changes. B & S sued and claimed that the termination was unlawful race discrimination under federal law, and that the purported basis for termination was pretextual. The district court granted Bridgestone's motion for summary judgment because it demonstrated a legitimate, nondiscriminatory reason for termination. B & S appealed.

The Sixth Circuit affirmed, citing testimony by Bridgestone that it was important for dealerships to provide a full line of tire and other services in light of increased competition and the availability of tires on the internet. Bridgestone provided internal documents as well as public reports demonstrating the shift in Bridgestone's strategy toward full tire service. Additionally, Bridgestone showed that it attempted to work with B & S to change its dealership in order to comport with Bridgestone's new strategy, but B & S was not interested. Finally, Bridgestone showed that it terminated other dealers for failing to fit within Bridgestone's market strategy. Because B & S failed to demonstrate a racial pretext for termination or disprove Bridgestone's legitimate basis, the Sixth Circuit affirmed dismissal of its discrimination claim.

STATE LAWS

WISCONSIN FEDERAL COURT REFUSES TO APPLY STATE FRANCHISE LAW REQUIREMENTS TO DEALER-DISTRIBUTOR RELATIONSHIP

A Wisconsin federal court recently upheld the termination of two dealer agreements, finding that the agreements were not subject to California and Washington state franchise laws, both of which require good cause for termination of an agreement. *PW Stoelting, L.L.C. v. Levine*, 2018 WL 6603874 (E.D. Wis. Dec. 17, 2018). This dispute arose after PW Stoelting, a manufacturer of food service and cleaning equipment, terminated, without cause, its agreements with two related dealers based in California and Washington. Although the agreements permitted termination without cause, the dealers argued that certain inventory purchase requirements constituted a "franchise fee," thus creating a franchise relationship under California and Washington state law. Because both states prohibit termination of a franchise relationship without good cause, the dealers argued that PW Stoelting's termination was invalid.

The court rejected the dealers' claim that payments for required quantities of inventory constituted a "franchise fee" under either California or Washington law, both of which specifically exclude from the franchise fee definition purchases of goods made at *bona fide* wholesale price. The court first analyzed California law, which limits the *bona fide* wholesale price exemption to quantities that a reasonable business person would purchase. Here, the dealers purchased goods at 45-50% of the list price, and were further required to maintain a certain level of inventory — approximately $70,000 for the California dealer. However, the cost of these goods was minimal in comparison to actual sales — the court noted that over the course of relationship, the dealers collectively purchased more than $20,000,000 worth of products and parts from PW Stoelting. Given the low relative cost of the minimum inventory requirement compared to the dollar amount of the California dealer's sales, the court held that no reasonable jury would find that this required inventory level at wholesale prices exceeds what a reasonable business person would normally purchase, and thus the mandatory purchases did not constitute a franchise fee under California law. The court reached the same conclusion under Washington law, finding that the purchases fell within the *bona fide* wholesale price exemption. As a result, because the fee element of a franchise was missing, the court found the distribution arrangements were not covered by the state franchise laws and upheld the termination of both agreements.

The dealers also claimed that PW Stoelting's termination notice was invalid because it was not sent directly to the dealers via U.S. mail. Rather, the manufacturer had sent the notices via UPS to the dealers' counsel, after receiving a letter from him demanding that all future correspondence from the manufacturer to the dealers be sent to him. Because the notice was deemed substantially compliant with the agreements, it was held to be valid.

ANTIWAIVER STATUTE DEFEATS CHOICE OF LAW PROVISION IN CONTRACT ENTERED INTO EIGHT YEARS BEFORE STATUTE'S ENACTMENT

A federal court in Minnesota denied a motion to dismiss a lawsuit alleging wrongful termination of a sales representative agreement. *Hedding v. Pneu Fast Co.*, 2019 WL 79006 (D. Minn. Jan. 2, 2019). Minnesota resident Curt Hedding was a sales representative for nail and staple manufacturer Pneu Fast. Under the parties' 2006 agreement, Hedding represented Pneu Fast in selling and distributing products across nine states, including Minnesota and Ohio. In 2018, Pneu Fast terminated the agreement without explanation or an opportunity to cure. Hedding filed suit, alleging the termination violated Minnesota's Termination of Sales Representative Act, which requires "good cause" for termination with notice and an opportunity to cure. Pneu Fast argued that the agreement's Ohio choice-of-law provision waived application of the Minnesota Act.

The court sided with Hedding, finding the Act was not waived. Although parties had previously been able to waive application of the Act, in 2014 the legislature added an antiwaiver provision that invalidated choice-of-law provisions in contracts with Minnesotan sales representatives that were "entered into, renewed or amended on or after" August 1, 2014. While recognizing that the parties' agreement predated the antiwaiver provision, and acknowledging that no written amendment or renewal had been executed, the court observed that the parties allegedly expanded Heddings' sales territory in 2015 and 2016, creating new obligations and costs in the process. The court also noted that the parties continued their relationship, despite being on notice of the Act's protections and passage of the antiwaiver provision. Finding that the territory expansion "renewed or amended" the agreement after August 1, 2014, the court held that the antiwaiver provision applied. It therefore nullified the Ohio choice-of-law provision and denied Pneu Fast's motion to dismiss.

ANTITRUST

FURNITURE RETAILER'S ANTITRUST CLAIMS AGAINST MANUFACTURER ARE DISMISSED, BUT CLAIMS FOR BREACH OF CONTRACT SURVIVE

A federal court in Nevada recently dismissed antitrust claims brought by a retailer that claimed it was harmed by a furniture manufacturer's online sales through Wayfair, but allowed contract claims against the manufacturer to proceed to discovery. *Furniture Royal, Inc. v. Schnadig Int'l*

Corp., 2018 WL 6574779 (D. Nev. Dec. 13, 2018). Furniture Royal, the retailer, had sold furniture manufactured by Schnadig since 2010. In 2017, while maintaining the relationship with Furniture Royal, Schnadig also began selling its furniture directly to consumers through the Wayfair website at prices well below MSRP. Faced with this competition from online sales, Furniture Royal filed suit against both Schnadig and Wayfair. Both defendants moved to dismiss.

The court dismissed Furniture Royal's antitrust claims asserted under Section 1 of the Sherman Act and the Robinson-Patman Act. According to the court, the Sherman Act claim failed because Furniture Royal failed to allege any details regarding Schnadig's alleged market power within a relevant market. The Robinson-Patman Act claim failed because the sales in which the alleged price discrimination occurred were to buyers at different levels of the distribution chain; sales to Furniture Royal were made to a retailer, whereas sales through the Wayfair website were made directly from the manufacturer to the consumer. In contrast, the court allowed contractual claims against Schnadig to proceed based on an alleged implied covenant not to compete established through the parties' prior course of dealing.

UNFAIR AND DECEPTIVE TRADE PRACTICES

FLORIDA FEDERAL COURT PARTIALLY DENIES DISTRIBUTOR'S MOTION FOR SUMMARY JUDGMENT ON STATUTORY UNFAIR AND DECEPTIVE TRADE PRACTICES CLAIMS

A federal court in Florida recently denied in part a distributor's motion for summary judgment in a suit brought against it by a dealer. *Gulf Coast Turf & Tractor LLC v. Kubota Tractor Corp.*, 2019 WL 1227776 (M.D. Fla. Mar. 15, 2019). Kubota Tractor distributes agricultural, construction, and outdoor power equipment through a network of dealers throughout the United States. Gulf Coast Turf and Tractor is one of Kubota's authorized dealers in Florida. In the Kubota system, dealers earn commissions from sales to private customers within their assigned territories. However, when large, national customers purchase their equipment directly from Kubota, Kubota has the discretion to designate a "delivering dealer" for each such sale to receive the commission. Gulf Coast sought to become the delivering dealer for all Florida sales to one such customer, Hertz Equipment Rental Corporation. However, Gulf Coast was unable to do so and claimed Kubota unfairly prevented it from cultivating a delivery dealer relationship with Hertz. Gulf Coast sued Kubota asserting a handful of claims, including claims under Florida statutes outlawing unfair methods of competition and unfair or deceptive acts or practices in the conduct of the distribution of equipment.

Kubota moved for summary judgement on the claims, arguing that the statutory violations were not actionable because they occurred prior to the effective date of the legislation. However, the court ruled that an identical version of the statute existed and applied to the conduct during the relevant time period. Kubota also contended that it had the right to

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designate a delivering dealer for national customers in its sole discretion. However, the court ruled that, even so, a claim may nonetheless exist if Kubota exercised that discretion unfairly. In addition, Kubota argued that even if the statutory claims could proceed, Gulf Coast could not recover any anticipated future lost profits related to Hertz because those types of damages are not available under the statute. The court agreed and granted Kubota summary judgment on that discrete issue. Finally, the court denied Kubota's motion for summary judgment on a common law tortious interference claim.

FRAUD

IDAHO SUPREME COURT UPHOLDS JUDGMENT FOR DISTRIBUTOR ON PROTECTED ACCOUNTS

The Supreme Court of Idaho has upheld a decision in favor of an authorized distributor of business forms who complained of losses related to protected accounts. *Thurston Enters. v. Safeguard Bus. Sys.*, 2019 WL 667966 (Idaho Feb. 19, 2019). Safeguard Business Systems, a supplier of business forms and products, had entered into a distributor agreement granting Thurston Enterprises the exclusive right to commissions on sales within a protected area. If another distributor sold Safeguard Systems products to a customer that had previously purchased products from Thurston, Safeguard would issue a "rotation notice" that would provide Thurston with the commission for the sale made by the other distributor. After Safeguard acquired a competitor and the competitor's distributor agreements, Thurston agreed to sell certain protected accounts for Safeguard to transfer to a newly acquired distributor.

Thurston brought suit when it found out that the newly acquired distributor had been selling Safeguard Systems products to Thurston's customers, and it argued that Safeguard fraudulently induced it to relinquish protected accounts without providing information about the commissions to which Thurston would have been entitled had it retained those accounts. The Idaho Supreme court affirmed the lower court's judgment for Thurston, rejecting Safeguard's argument that the protection clause only applied to sales of the same product to a particular customer. The court noted that the clause gave Thurston the right to commissions on any Safeguard Systems product sold to one of Thurston's customers, regardless of whether Thurston had previously sold that same product to the customer. The court also upheld the fraud claim, rejecting Safeguard's argument that Thurston was aware before selling account rights that the newly acquired distributor had made sales to those customers. The court noted that Safeguard never issued a "rotation notice" to Thurston, who therefore did not know that the new distributor had specifically made sales of Safeguard Systems products that would be subject to the protection clause.

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