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 dealer termination, antitrust, application of state statutes, and more.

ANTITRUST

FOURTH CIRCUIT ALLOWS MONOPOLIZATION ATTACK ON MULTI-YEAR SUPPLY AGREEMENTS

The United States Court of Appeals for the Fourth Circuit recently reversed the dismissal of a claim brought by a competing manufacturer that alleged DuPont attempted to wield, and did wield, monopoly power over the U.S. para-aramid fiber market in violation of Section 2 of the Sherman Act. E.I. du Pont de Nemours and Co. v. Kolon Industries, Inc., 2011 U.S. App. LEXIS 4752 (4th Cir. March 11, 2011). DuPont had brought a trade secrets suit against Kolon, a relative newcomer to para-aramid production. Kolon counterclaimed that DuPont had monopolized and had attempted to monopolize the United States para-aramid market by illegally using multi-year supply agreements with high-volume customers. Those agreements required high-volume customers to purchase 80 to 100 percent of their para-aramid requirements from DuPont. Kolon alleged that those agreements removed substantial commercial opportunities from competition and limited other para-aramid fiber producers’ ability to compete.
A federal district court in Virginia granted DuPont’s motion to dismiss the claim because, in part, Kolon had inadequately pled the relevant geographic market by failing to include supplier headquarter sites, even those outside the United States. Reversing the district court’s dismissal, the Fourth Circuit noted that the relevant market is a “deeply fact-intensive inquiry” and “no federal appellate court has held that supplier headquarter sites must, as a matter of law, be included in the relevant geographic market definition in Sherman Act cases.” The court reminded the district court that the relevant geographic market inquiry “focuses on that geographic area within which the defendants’ customers who are affected by the challenged practice can practicably turn to alternative supplies if the defendant were to raise its prices or restrict its output.”

POST-LEEgin CHALLENGES TO RESALE PRICE CONTROLS CONTINUE TO HAVE VARIED SUCCESS

The United States Supreme Court in its 2007 Leegin decision ruled that resale price controls by manufacturers and others would be judged under the more lenient standard of the rule of reason, at least under federal antitrust law. Since then, other than in the post-remand developments in Leegin itself, most of the legal activity has been at the state level. Two states recently reached different results in their enforcement efforts, however, and the Supreme Court refused to grant further review of the final judgment in Leegin.

First, on January 11, California entered into a consent decree with a cosmetics manufacturer that had been prohibiting discounting by Internet dealers. California v. Bioelements, Inc., No. 10011659 (Cal. Sup. Ct. Jan. 11, 2011). Although the manufacturer was required to stop controlling Internet discounts, this result was achieved by settlement rather than a court decision, so its weight can be questioned. Then, three days later, New York lost its court case against a mattress manufacturer that it had accused of illegally prohibiting certain discounting practices. New York v. Tempur-Pedic Int’l, Inc., No. 400837/10 (N.Y. Sup. Ct. Jan. 14, 2011). The court held that a state statute making resale price contracts “unenforceable” does not make them illegal.

On February 22, the Supreme Court denied certiorari on the plaintiff retailer’s appeal from the final judgment in Leegin after remand. In the end, the ultimate decision of the district court to dismiss the retailer’s claims for lack of a showing of a viable relevant market prevailed, and the rule of reason stands as a hurdle for plaintiffs’ challenges to resale price controls under federal antitrust law.
SALES REPRESENTATIVE TERMINATION

ABUSE OF “HOUSE ACCOUNTS” CLAUSE AMOUNTED TO CONSTRUCTIVE TERMINATION OF SALES REPRESENTATIVE AGREEMENT

In Kamco Industrial Sales, Inc. v. Lovejoy, Inc., 2011 U.S. Dist. LEXIS 25240 (E.D. Pa. Mar. 10, 2011), a commissioned sales representative sued the manufacturer for whom it sold products, alleging breach of contract and breach of the implied covenant of good faith and fair dealing. The sales representative agreement at issue required the plaintiff to sell the defendant’s power transmission products on an exclusive basis. The agreement term automatically renewed on a year to year basis, unless either party gave 60 days’ notice of nonrenewal. The agreement also contained a provision that defined certain customers as “house accounts.” For these customers, defendant could sell directly and the plaintiff would receive no sales commissions. The agreement broadly gave the defendant “the right to redefine these accounts.” As part of an effort to reduce overall costs and become more competitive in the marketplace, the defendant manufacturer sought to terminate the sales representative agreement in the middle of its term. When plaintiff did not agree to terminate, the defendant elected to redefine the “house accounts” list so that it included substantially all of plaintiff’s customers.

The Eastern District of Pennsylvania determined that, although it had not yet done so, the Pennsylvania Supreme Court would adopt the concept of a covenant of good faith implied into every contract. The court also found that the defendant’s redefinition of the house accounts list to include all of the plaintiff’s customers amounted to a breach of the covenant because it exploited a provision giving the defendant broad discretion to deny the plaintiff any benefit under the agreement. Moreover, the defendant’s use of the house account clause to functionally end the parties’ relationship rendered the automatic renewal, notice, and termination provisions of the agreement meaningless. The court granted summary judgment in favor of the plaintiff.

TERMINATIONS

UNDER OHIO LAW, MANUFACTURERS’ NEW JOINT VENTURE COULD NOT TERMINATE BEER DISTRIBUTORS WITHOUT JUST CAUSE

The Ohio Alcoholic Beverages Franchise Act (“ABFA”) precludes a manufacturer from terminating a distributor of alcoholic beverages without consent or just cause. The statute specifies that “a manufacturer’s sale, assignment, or other transfer of the manufacturer’s product or brand to another manufacturer over which it exercises control” does not constitute just cause to terminate a distributor, but that just cause is not required for termination that occurs within 90 days of “a successor
manufacturer[‘s] acqui[sition of] all or substantially all of the stock or assets of another manufacturer through merger or acquisition . . . .”

When Miller and Coors formed a joint venture called MillerCoors and then terminated existing Miller and Coors wholesale distributors, the distributors filed suit, alleging that the termination violated the ABFA because it was without just cause. In Beverage Distributors, Inc. v. Miller Brewing Company, 2011 U.S. Dist. LEXIS 30583 (S.D. Ohio Mar. 22, 2011), an Ohio federal court granted the distributors’ motion for summary judgment. The court found that Miller and Coors each exercised control over the MillerCoors joint venture, so there was no just cause for termination under the ABFA. The court also held that this ability to exercise control over the joint venture precluded MillerCoors from being a protected “successor manufacturer” under the statute.

“SUCCESSOR MANUFACTURERS” UNDER ABFA ALSO MUST COMPLY WITH TERMS OF DISTRIBUTOR AGREEMENTS REGARDING TERMINATION

In another Ohio case brought under the same statute as referenced immediately above, the court granted summary judgment on the plaintiff beer distributors’ claims that they were terminated improperly by a successor manufacturer. The Bellas Company v. Pabst Brewing Co., 2011 U.S. Dist. LEXIS 24781 (S.D. Ohio Mar. 11, 2011). After a new entity acquired all of the stock of Pabst Brewing Co. under a Stock Purchase Agreement, the new entity terminated the plaintiff distributors without providing sixty days notice prior to termination as required under the existing distribution agreements. The new entity relied on Section 1333.85(D) of the Ohio Alcoholic Beverages Franchise Act, which permits successor entities to terminate distribution agreements within 90 days of the merger or acquisition. The court held that the written distribution agreements with the plaintiff distributors were binding on the successor entity and that the ABFA neither conflicted with nor superseded contractual terms regarding notice of termination, thus the defendant successor entity breached the distribution agreements as a matter of law when it failed to give the contractual notice.

COURT FOR NOW REJECTS MANUFACTURER’S ATTEMPT TO TERMINATE DEALERSHIP THAT FAILED TO SIGN CURRENT FORM OF AGREEMENT

The dispute in Kaeser Compressors, Inc. v. Compressor & Pump Repair Services, 2011 U.S. Dist. LEXIS 15111 (E.D. Wis. Feb. 14, 2011), developed because Compressor & Pump Repair Services (“CPR”) refused to sign the current form of dealership agreement offered by its supplier, Kaeser. CPR had been Kaeser’s exclusive dealer in the territory for over 20 years, but when Kaeser requested that CPR sign its current form of dealership agreement, which provided for a non-exclusive territory, CPR refused. Consequently, Kaeser brought a declaratory judgment action asking the court to confirm that it had
good cause to terminate the dealership agreement under the Wisconsin Fair Dealership Law.

Under the WFDL, a distributor can only terminate an agreement for good cause, which includes a dealer’s failure to comply with “essential and reasonable requirements imposed upon him by the grantor,” as long as the same requirements are imposed on “similarly situated dealers.” Kaeser argued that the requirement to sign its current agreement was essential because it was important to have uniform contracts among its dealers and that the terms of the contract were commercially reasonable. In addition, all other dealers in its system signed the current agreement. CPR argued that there was a genuine issue of material fact as to whether the current dealership agreement was both essential and reasonable, arguing that changing the territory from exclusive to nonexclusive was neither essential nor reasonable. The court concluded that material facts were in dispute, warranting a denial of the motion.

Separately, the court dismissed CPR’s counterclaims alleging that Kaeser constructively terminated the dealership agreement by asking CPR to sign the current agreement, finding that the parties were still operating under the old agreement. Finally, the court allowed Kaeser to terminate CPR’s territory located in Minnesota, finding that although the Wisconsin and Minnesota territories were governed by the same agreement, the WFDL applies only to territories located in Wisconsin.

BUYER NOT OBLIGATED TO CONTINUE UNDER DISTRIBUTION AGREEMENT AS “MERE CONTINUATION” OF SELLER

In Progressive Septic, Inc. v. SeptiTech, LLC, 2011 U.S. Dist. LEXIS 27381 (D. Md. Mar. 15, 2011), a financially distressed manufacturer of septic systems sold the bulk of its assets to a new investor group. In the asset purchase agreement, the buyer explicitly declined to assume both the seller’s liabilities and its existing product distribution agreements. The buyer’s newly formed entity did adopt the trade name of the seller, however, and it hired several of the same management-level employees and continued to manufacture and distribute septic systems. The plaintiff was a distributor that previously had entered into an exclusive distribution agreement with the seller. After the sale, the new entity desired to move forward with the plaintiff distributor on a nonexclusive basis. In its suit, the plaintiff alleged that the new entity’s owners had orally agreed to keep the old distribution agreement in effect. The defendant countered that a letter had been sent to the plaintiff by the sales manager (of both the old company and the new one) stating that the new company would not be assuming presale distribution agreements.

The court found that the new entity had effectively terminated the old distribution agreement. That agreement permitted either party to terminate upon 60 days’ written notice. Because the letter from the sales manager notified the plaintiff that the new
entity would not continue under the old agreement, and the company then stopped selling products to plaintiff for a period greater than 60 days, the letter served as an effective termination, despite not being styled as a termination notice. Even if this were not the case, the court determined that the new entity could be bound by the old distribution agreement only if: (a) it had expressly assumed the old agreement or (b) its business was found to be a “mere continuation” of the old (seller) entity. It was clear that the new entity had expressly rejected the distribution agreement, both in the asset purchase documents and in the letter sent to plaintiff. And the Maryland court in this case found that the new business was not a mere continuation of the seller because ample consideration was paid for the assets of the old business, there was no continuation of ownership and upper-level management, and there was no evidence of fraud or improper purpose in the asset purchase agreement. The court determined that successor liability would not apply unless the sale and the formation of the new entity amounted to a bad faith attempt by the old company’s owners to evade creditors. Summary judgment was granted.

DAMAGES

NO ATTORNEYS’ FEES AWARDED IN DISTRIBUTOR’S CASE UNDER NEW JERSEY LAW

A recent decision in Warren Distributing Co. et al. v. Inbev USA and Anheuser-Busch, Inc., 2011 U.S. Dist. LEXIS 19721 (D.N.J. Feb. 28, 2011), demonstrated the significant limitations that courts may impose on the award of attorneys’ fees to prevailing parties. In this case under New Jersey law, after more than three years of litigation and a 13-day jury trial, the plaintiffs, who are former beer distributors for Anheuser-Busch, were awarded damages of $390,000 for Anheuser-Busch’s violations of New Jersey’s Malt Alcoholic Beverage Practices Act. However, Anheuser-Busch recovered over $638,000 from the beer distributors on its counterclaims for unjust enrichment and tortious interference.

The beer distributors then sought recovery of the $4.2 million in attorneys’ fees they had spent on the case under the New Jersey industry statute, which allows a wholesaler who is “successful” on a claim for violation of the statute to recover the cost of the action including “reasonable attorneys’ fees.” The court found that although Anheuser-Busch was the “prevailing party” in the case because it had recovered more in the way of damages than did the distributors, the latter had “successfully” litigated their statutory claim and were technically entitled to recover the fees they incurred. The court then closely analyzed the distributors’ fees petition. While the court found reasonable the hourly rates for senior litigators—who charged $750—and the number of hours spent on the claims, the court nevertheless ruled that the distributors would not get a penny of what they had spent on the case. The court found that the overall
outcome of the litigation favored Anheuser-Busch and that the amount of damages awarded to the distributors was “nugatory” compared to $41 million they claimed in damages. In addition, the court noted that the distributors had turned down a settlement offer before the action was filed that would have paid them exactly the amount they ended up winning on their claims. Thus, the court noted, after three and a half years of litigation and a long jury trial, the distributors “landed in the same position they had occupied months before the beginning of the litigation.” Accordingly, it reduced the fees award by “one hundred percent.”

IOWA APPEALS COURT ALLOWS MONETARY DAMAGES UNDER STATE FARM IMPLEMENTS DEALER LAW

The Iowa Court of Appeals has overturned a trial court’s decision and allowed a dealer to recover monetary damages under the Iowa Farm Implements Dealer Law. The case is FECO, Ltd. v. Highway Equip. Co., Inc., Bus. Franchise Guide (CCH) ¶ 14,522 (Iowa Ct. App. Dec. 22, 2010). The manufacturer had admitted that it did not have good cause to terminate the dealership agreement. At issue then was the interpretation of various provisions of the statute, including its Section 322F.7, which sets forth a list of violations. Section 322F.8 in turn states that monetary damages are allowed for a violation of “this chapter.” The manufacturer contended that, because termination without good cause is not explicitly listed in Section 322F.7, the manufacturer was not liable for monetary damages. The appellate court disagreed. According to the court, the language in Section 322F.8 that a dealer may recover damages when there is a violation of “this chapter” refers to all parts of the Iowa Farm Implements Dealer Law, not just to those violations specifically enumerated in Section 322F.7. Because good cause for termination is required elsewhere in the statute, the appellate court reversed and remanded to the trial court.

STATE FRANCHISE LAWS

ILLINOIS COURT FINDS NO FRANCHISE RELATIONSHIP BETWEEN SUPPLIER AND DISTRIBUTOR UNDER CONNECTICUT LAW

In Echo, Inc. v. Timberland Machines & Irrigation, Inc., et al., 2011 U.S. Dist. LEXIS 4574 (N.D. Ill. Jan. 18, 2011), the United States District Court for the Northern District of Illinois granted a supplier’s motion for summary judgment against its former distributor, finding that the Connecticut Franchise Act did not offer the distributor its protections because the parties were not in a franchise relationship. Echo, an Illinois-based supplier of power equipment products, terminated its distributor agreement with Timberland, a Connecticut-based distributor, and filed suit against Timberland to recover past due fees. Timberland filed counterclaims, alleging, among other things, that Echo violated the CFA when it terminated the distributor agreement. Echo moved
for summary judgment on Timberland’s claim under the CFA, arguing that the statute did not apply because the parties were not in a franchise relationship.

In granting Echo’s motion for summary judgment, the court found that the CFA’s protections only apply to business relationships that fall within the statute’s definition of a franchise, which requires that the plaintiff’s business be substantially associated with the defendant’s trademark. Specifically, the court noted that a plaintiff must derive at least one half of its total sales or gross profits from sales of the defendant’s products in order for there to be a substantial association between the parties. In this case, the court found that such an association did not exist; sales of Echo products constituted 30% to 35% of Timberland’s total sales from 2004 to 2008, and Echo products never accounted for 50% or more of Timberland’s gross profits. Thus, the court held that the lack of a substantial association between the parties precluded Timberland from establishing the existence of a franchise relationship with Echo and from maintaining an action under the CFA.

CONTRACTS

COURT GRANTS SUMMARY JUDGMENT TO BEER SUPPLIER ON DISTRIBUTOR’S BREACH OF IMPLIED CONTRACT CLAIM

In Boon Rawd Trading International Co., Ltd. v. Paleewong Trading Co., 2011 U.S. Dist. LEXIS 24963 (N.D. Cal. Mar. 8, 2011), a California federal district court recently granted a supplier’s motion for summary judgment on all claims in a contract dispute with a long-time United States importer and distributor of its Singha Beer products. Although it was undisputed that the parties never had a written contract or even an oral agreement, the distributor claimed that an implied contract under California Civil Code § 1621 had manifested over the course of the parties’ 30-year business relationship. While the court addressed several issues, it held that the distributor had “not proffered one scintilla of admissible evidence” of an implied importation contract between the parties, finding that their course of conduct did not equate to a meeting of the minds or a mutual promise to comply with agreed upon terms. Despite evidence that the distributor served for many years as the only importer of Singha Beer in certain areas of the United States, this fact alone, the court held, did not imply a “mutual understanding” that the distributor either had an indefinite right to import Singha Beer or that the right could only terminate with good cause and by compensating the distributor.

The court also denied the distributor’s claim under the California Franchise Relations Act because no express or implied contract existed, let alone a franchise agreement. The court also determined that an importation business is not a “franchise” under the Act because an importer is not “offering, selling or distributing goods or services.”
COLORADO COURT APPLIES UCC TO DEALERSHIP AGREEMENT

A Colorado federal district court recently held that the Colorado Uniform Commercial Code governed a dealership agreement in Precision Fitness Equip., Inc. v. Nautilus, Inc., 2011 U.S. Dist. LEXIS 13576 (D. Colo. Feb. 2, 2011). This case required the court to consider the admissibility of extrinsic evidence to interpret a contract provision, an issue that may be decided differently depending on whether the UCC or the common law applies. To make this determination, Colorado courts look to whether the primary purpose of the contract is the sale of goods or services. Since the Colorado Supreme Court had not addressed the proper classification of a dealership or distributorship agreement, the federal court looked to decisions from other courts and found that a strong majority of jurisdictions have concluded that the UCC governed dealership and distributorship agreements. In addition, the court found that the primary purpose of the contract before it was the sale of Nautilus’ goods. Accordingly, the court held that the UCC governed the agreement.

The court discussed Rocky Mountain Chocolate Factory, Inc. v. SDMS, Inc., No. 06-cv-11212-WYD-BNB, 2007 WL 4268962, at *4-5 (D. Colo. Nov. 30, 2007), which held that the Colorado UCC was inapplicable to a franchise agreement. The Rocky Mountain court found that the primary purpose of the agreement was not the sale of goods, but rather “allowing and enabling Defendants to set up and operate a franchise and use its marks and products.” However, the Precision Fitness court did not view Rocky Mountain as controlling because it was “an unreported decision, and its facts are distinguishable.”
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