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 antitrust, terminations, and damages.

## DUTY OF GOOD FAITH AND FAIR DEALING

### SEVENTH CIRCUIT AFFIRMS FINDING THAT CONSTRUCTIVE TERMINATION VIOLATED DUTY OF GOOD FAITH AND FAIR DEALING

The United States Court of Appeals for the Seventh Circuit recently held there was sufficient evidence to support a jury's determination that a manufacturer breached the duty of good faith and fair dealing implied into a dealer agreement. In *Tilstra v. BouMatic LLC*, 2015 WL 3953403 (7th Cir. June 30, 2015), Tilstra was a dealer of BouMatic dairy equipment, with a particularly lucrative exclusive dealership territory. Under the dealer agreement between the parties, BouMatic had the right to modify the assigned dealership territory "at its sole discretion," but could not terminate the agreement without "good cause." In an effort to force Tilstra to sell its dealership to a neighboring BouMatic dealer, BouMatic allegedly threatened to modify and effectively eliminate Tilstra's exclusive territory, which, Tilstra claimed, would have put it out of business.

At trial, the jury found that although BouMatic did not purport to terminate the distribution agreement directly, its actions amounted to a *constructive* termination, which lacked the required "good cause." Under Wisconsin law, the implied covenant of good faith and fair dealing requires a party to exercise discretionary rights in a manner that does not deprive the other of the benefit of its bargain. As a result, BouMatic's constructive termination was found to be a violation of the covenant, even though BouMatic had the explicit right to modify Tilstra's exclusive territory. On appeal, the Seventh Circuit affirmed the decision, reasoning that the jury had sufficient grounds to find that BouMatic, by threatening Tilstra with a drastic reduction in territory if it did not sell to a competing dealer, constructively terminated the agreement and in so doing, violated the duty of good faith and fair dealing in the performance of its contractual obligations.

## ANTITRUST

### FTC INJUNCTION TO BLOCK MERGER OF FOOD SERVICE DISTRIBUTORS UPHELD BY FEDERAL DISTRICT COURT

In a case closely followed in the franchising and distribution industries, the proposed merger of national distributors Sysco Corporation and US Foods, Inc. has been blocked. *FTC v. Sysco Corp.*, 2015 U.S. Dist. LEXIS 83482 (D.D.C. June 23, 2015). Upholding the administrative injunction, the United States District Court in Washington, D.C. agreed with antitrust concerns raised by the Federal Trade Commission. Many restaurant chain franchisors and others had been asked to support or refute these concerns as witnesses in the case, due to the close vendor relationships between food franchise systems and the distributors. The issue centered on whether the merged entity would have harmed competition in the broadline distribution of products to food service outlets. Competitive harm was inevitable, the court found.

Shortly after this ruling, Sysco and US Foods abandoned their attempts to merge.

### RULING THAT APPLE CONSPIRED WITH BOOK MANUFACTURERS AFFIRMED

Finding Apple, Inc. *per se* liable under the Sherman Antitrust Act, the United States Court of Appeals for the Second Circuit has affirmed a district court's important ruling from 2013 in *United States v. Apple*, 2015 WL 3953243 (2d Cir. June 30, 2015). The appellate court agreed that Apple orchestrated what became a "horizontal" agreement among nearly all major book publishing companies to fix (and raise) prices of electronic books. Based on this analysis of the situation as horizontal—including the unique role of Apple, a nonpublisher—the court held Apple's conduct to be a *per se* unreasonable restraint of competition.

What did Apple do? The court affirmed that Apple entered into its separate contracts with each publisher as part of a coordinated effort to wrest control of the e-book industry from Amazon and its early Kindle product. These agreements, which all employed an "agency model" and "most favored nations" clauses benefitting Apple, had the intent and effect of increasing prices.

## ELEVENTH CIRCUIT AFFIRMS FTC FINDING THAT MANUFACTURER'S EXCLUSIVE DEALING PROGRAM WAS CREATED TO MAINTAIN MONOPOLY POWER

The United States Court of Appeals for the Eleventh Circuit has affirmed the Federal Trade Commission's finding that McWane, Inc. violated Section 5 of the FTC Act when it developed an exclusive dealing program to maintain monopoly power in the domestic fittings market. *McWane, Inc. v. FTC*, 783 F.3d 814 (11th Cir. Apr. 15, 2015). The FTC initiated the enforcement action against McWane, a manufacturer of iron pipe fittings primarily used by municipal water authorities, for requiring exclusivity from its distributors. After a new manufacturer, Star Pipe Products, entered the domestic fittings market in 2009, McWane announced to its distributors that unless all domestic fittings were purchased from McWane, rebates would be forfeited and the distributors would be cut off from purchases for 12 weeks. An FTC administrative law judge found the program to be an illegal exclusive dealing policy. On a vote of 3-1, the FTC affirmed and ordered McWane to stop requiring exclusivity.

The appellate court affirmed, finding the FTC defined a relevant market, demonstrated a monopoly of power existed in that market, and showed McWane's program constituted illegal maintenance of that monopoly power. The court agreed with the FTC that domestic and imported fittings constituted two separate markets based on price differences, distinct customer base, and lack of reasonable substitutes. The appellate court also found a monopoly existed, as evidenced by McWane's ability to exclude competition, impact prices, and its overwhelming market share. Finally, the appellate court agreed that McWane intentionally tried to maintain its monopoly power. Even though the program was short term, its "practical effect" was to make it economically infeasible for distributors to switch to a competitor, which had a "probable effect" of substantially lessening competition in the market. McWane was hurt by evidence showing that it actually maintained its dominance even after increasing its prices, and by testimony from McWane executives that the program was deliberately created to freeze out Star from gaining a substantial market share.

## COURT DENIES MOTION TO DISMISS ROBINSON-PATMAN ACT CLAIM BASED ON ALLEGED INDUCEMENT OF DISCRIMINATORY PRICING

The United States District Court for the Western District of Pennsylvania recently denied in part a motion to dismiss a distributor's claims against a competing manufacturer-distributor for breach of contract and unlawful price discrimination. *AlarMax Distributors, Inc. v. Honeywell International, Inc.*, 2015 WL 3645259 (W.D. Pa. June 9, 2015), involved a wholesale distributor of electronic fire and security products, AlarMax, that purchased its inventory from several companies, including defendant Honeywell. In addition to its manufacturing activities, Honeywell also operates ADI Global Distribution, the world's largest distributor of electronic fire and security products.

AlarMax and Honeywell had previously entered into a settlement agreement and supply agreement that required Honeywell to sell its products to AlarMax on the same terms Honeywell offered to other distributors, and obligated Honeywell not to accept more favorable pricing terms from third-party manufacturers than were offered to AlarMax. AlarMax filed suit in 2014 after discovering evidence allegedly showing that Honeywell was violating the parties' agreements and section 13(f) of the Robinson-Patman Act, including by offering better pricing to other distributors than to AlarMax and by requiring vendors to give ADI better pricing than AlarMax received from those vendors.

Honeywell moved to dismiss, but the court allowed the Robinson-Patman Act claim to stand. It concluded that AlarMax had made factual allegations sufficient to raise a reasonable inference that manufacturers were charging AlarMax higher prices than they charged Honeywell. In so concluding, the court rejected Honeywell's argument that AlarMax needed to specifically plead "which products it bought, from whom, at what time, and at what allegedly higher prices than Honeywell paid for the same products." Finally, the court ADI's vendor agreement with third parties, which required Honeywell to receive lower prices than its competitors, supported a reasonable inference that Honeywell was knowingly inducing or receiving discriminatory pricing.

## STATE FRANCHISE LAWS

### THIRD CIRCUIT LIMITS REPURCHASE OBLIGATIONS UNDER DELAWARE STATUTE

The Third Circuit Court of Appeals, after certifying the issue to the Delaware Supreme Court, has ruled that a supplier's inventory repurchase obligation under Delaware's dealer law is limited to new, unused, undamaged and complete inventory. *Southern Track & Pump, Inc. v. Terex Corp.*, 2015 U.S. App. LEXIS 11190 (3d Cir. June 30, 2015). Plaintiff Southern Track terminated its distributorship agreement with Terex after Southern Track had difficulty marketing approximately $4 million worth of construction equipment purchased from Terex. Although Delaware's Equipment Dealer Contracts Statute required suppliers to repurchase "all inventory previously purchased from the supplier that remains unsold," Terex refused to repurchase used equipment that Southern Track had been leasing to its customers. While negotiating the scope of equipment Terex would repurchase, Southern Track's creditor repossessed the equipment under a financing agreement and the lawsuit ensued.

The trial court granted summary judgment in favor of the dealer, finding that Terex violated the statute by refusing to repurchase all of Southern Track's unsold inventory, and ordered Terex to pay 100 percent of the inventory's net price pursuant to the prescribed statutory relief. On appeal, the Third Circuit certified the question of repurchase obligations under the statute to the Delaware Supreme Court to clarify whether it applied to "all" inventory, or only "new, unused, undamaged and complete inventory." The Delaware Supreme Court concluded that the statute was ambiguous and subject to two different interpretations, but noted that the law specifically outlined pricing formulas for new and unused equipment, yet was silent on a pricing scheme for inventory that was not new and unused. Concluding it would be inconsistent with "the statute's overall level of detail to infer by the legislature's silence that it intended to require the repurchase of used equipment," the court ruled that the repurchase obligation was limited to "new, unused, undamaged and complete inventory." Based on the state supreme court's comprehensive opinion, the Third Circuit reversed the ruling in favor of Southern Track.

## WISCONSIN DISTRICT COURT GRANTS DISTRIBUTOR'S MOTION FOR SUMMARY JUDGMENT AS TO LIABILITY UNDER TEXAS DEALER STATUTE

A Wisconsin district court granted a distributor's motion for summary judgment finding that the distributor was entitled to the termination protections provided by the Texas Fair Practices of Equipment Manufacturers, Distributors, Wholesalers and Dealers Act (the "FPA") even though no written agreement existed between distributor and manufacturer. *Texas UJoints, LLC v. Dana Holding Corp.*, 2015 WL 3454431 (E.D. Wis. June 1, 2015). In 2012, Texas UJoints, a distributor, acquired the assets of Automotive Industrial Supply Co., Inc. ("AISCO"), a distributor of Dana's industrial drive lines and universal joints. While no written distribution agreement existed between AISCO and Dana at the time of the acquisition, the purchase agreement expressly transferred to Texas UJoints "all contracts" and "all contract rights." After the acquisition, Texas UJoints sent Dana a credit application and Dana fulfilled a number of product orders, but Dana later notified Texas UJoints that it would not continue a relationship with it.

In opposition to Texas UJoints' motion for summary judgment, Dana first argued that the FPA's provisions requiring notice and opportunity to cure did not apply, as it never entered into a dealer agreement with Texas UJoints, and any prior relationship it had with AISCO was irrelevant. The court reasoned, however, that the FPA applied not only to written agreements but also covered informal agreements, including the informal distribution agreement between Dana and AISCO which was transferred to Texas UJoints as a "dealer contract" in connection with the acquisition. In the alternative, Dana cited the FPA's language that good cause exists if "there has been a sale or other closeout of a substantial part of the dealer's assets related to the business" and argued it had good cause under the FPA to terminate without providing notice or an opportunity to cure. In rejecting this argument, the court noted that the FPA was not designed to preclude a dealer from transferring its dealer agreement to a qualified third party, but rather provided a manufacturer with immediate termination rights in the event a distributor sells all of its assets without an assignment of the dealership agreement or rights to a third party.

## CHOICE OF FORUM/VENUE

### FIRST CIRCUIT UPHOLDS FORUM SELECTION CLAUSE IN SALES INVOICES

The United States Court of Appeals for the First Circuit recently affirmed a decision enforcing a forum selection clause contained in sales invoices that partially governed the relationship between a manufacturer and its local retailer. *Carter's of New Bedford, Inc. v. Nike, Inc.*, 2015 U.S. App. LEXIS 10692 (1st Cir. June 24, 2015). The dispute arose when Nike notified Carter's, a clothing and footwear business located in Massachusetts and longtime retailer of Nike products, that it was terminating the parties' relationship. When Carter's brought suit in Massachusetts seeking to prevent the termination, Nike moved to dismiss the case on the grounds that the forum selection clause contained in invoices exchanged between the parties required Carter's to file its claims in Oregon. The district court found that Carter's had not met its burden to show that the clause was unconscionable or inapplicable and granted Nike's motion.

On appeal, the First Circuit agreed that the forum selection clause was valid and enforceable and that the action was properly dismissed. The court noted that Carter's had admitted in its complaint that the terms and conditions of the invoices, in addition to other agreements, defined the parties' business relationship. The court also rejected Carter's position that the forum selection clause should be limited to issues concerning the goods covered by each invoice, instead finding that the broad terms of the clause encompassed all claims. The court further determined that Carter's had waived any argument that Nike unilaterally added the forum selection clause to the invoices without bargaining for its inclusion. Finally, the court concluded that enforcement of the clause was not unreasonable, unjust, or contrary to Massachusetts public policy and that Carter's was capable of litigating its claims against Nike in Oregon.

## DAMAGES TO DEALER

### FEDERAL COURT DETERMINES DIMINISHED VALUE OF DISTRIBUTORSHIPS EXCEEDS $3 MILLION

The United States District Court for the Southern District of Ohio found that, under Ohio's Alcoholic Beverage Franchise Act, the diminished value of a terminated distributorship agreement includes the fair market value of the franchise contracts (including goodwill), plus any loss in the fair market value of the other tangible or intangible components of the distributorship resulting directly from loss of the brands. *Tri County Wholesale Distribs., Inc. v. Labatt USA Operating Co.*, 2015 U.S. Dist LEXIS 81914 (S.D. Ohio June 24, 2015). Labatt, a successor manufacturer, had terminated the agreements of Tri County, its Ohio distributors, without cause. Although the court ruled that termination of the distributorship agreement was proper, it required Labatt to purchase Tri County's inventory and compensate the distributor for the diminished value of its businesses directly related to the sale of Labatt's product.

The court held that Tri County was entitled to $3,059,179 to compensate for the diminished value of its business as a result of the loss of Labatt's brand. To calculate this value, the court determined the fair market value of the distributor contracts using a discounted cash flow analysis, and added the loss in fair market value to other tangible or intangible components of the distributorship directly resulting from loss of the brand. The loss in goodwill was also added. The court further held that post-termination benefits received by Tri County could not be deducted from the diminished fair market value amount because the Act did not provide for such a deduction.

## CONTRACTS

### FEDERAL COURT BARS CLAIMS FOR BREACH OF ORAL DISTRIBUTION AGREEMENT

In *LightStyles, Ltd. v. Marvin Lumber & Cedar Co.*, 2015 U.S. Dist. LEXIS 86954 (M.D. Pa. July 6, 2015), a federal court granted summary judgment in favor of manufacturer Marvin against a distributor, LightStyles, after Marvin terminated the parties' oral distribution agreement of sixteen years. LightStyles brought claims for (1) breach of contract, (2) breach of the covenant of good faith and fair dealing, (3) breach of a franchise agreement; (4) breach of fiduciary duty, (5) unjust enrichment, (6) promissory estoppel, and (7) intentional interference with business and contractual relationships. Marvin moved for summary judgment on all claims, arguing, in part, that the statute of frauds barred LightStyles's claims and that LightStyles was not a franchise.

The court agreed with Marvin, holding that none of the recognized exceptions to the requirement of the statute of frauds that the distribution agreement be in writing applied. Specifically, the court observed that LightStyles had failed to establish Marvin had *admitted* to the existence of the contract terms that the distributor sought to enforce; that Marvin had demonstrated the existence of those terms through its *performance* under the agreement; or that the terms that LightStyles sought to enforce were customarily incorporated in oral agreements as a matter of *trade practice*. The court also held that even if the statute of frauds did not bar LightStyles's contract-based claims, LightStyles could not assert a claim for breach of franchise agreement because it failed to show that Marvin exerted sufficient control over LightStyles to create a franchise relationship. The court noted, among other things, that LightStyles did not operate under the Marvin name; that, while LightStyles could not sell windows that competed with Marvin windows or sell Marvin windows outside of its assigned territory, LightStyles could and did sell nonMarvin products; and that LightStyles did not have to pay a franchise fee.

## TERMINATIONS

### WISCONSIN COURT OF APPEALS AFFIRMS JURY FINDING THAT GRANTOR LACKED GOOD CAUSE FOR TERMINATING DEALERSHIP AGREEMENT

The Wisconsin Court of Appeals affirmed a jury's finding that a manufacturer, CNH America, terminated a dealership agreement without good cause in violation of Wisconsin's Fair Dealership Law, finding that CNH had imposed a market share requirement that discriminated against small dealers. *Chili Implement Co. v. CNH Am., LLC*, 362 Wis. 2d 540 (Wis. Ct. App. Apr. 30, 2015). CNH, an agricultural equipment manufacturer, granted a dealership to Chili Implement. During the term of their agreement, CNH sent Chili a notice stating, in part, that Chili needed "to meet or exceed 90% of the Wisconsin state market share" to avoid termination. When Chili failed to meet CNH's requirements, CNH terminated the agreement. Chili filed suit, and the circuit court held that CNH had terminated the agreement without good cause.

On appeal, CNH argued that the circuit court should have granted its summary judgment motion because Chili's claim was time barred by the Wisconsin Fair Dealership Law's one-year statute of limitations. CNH also appealed the lower court's finding on the merits of the case. The appellate court held that the statute of limitations did not begin to run when CNH sent the notice to Chili—even assuming that it could be considered a termination notice—because Chili's claim that CNH lacked good cause for terminating the agreement arose subsequent to Chili's receipt of the notice. The court further observed that, under Wisconsin's Fair Dealership Law, a dealership grantor has good cause to terminate a dealership agreement if the dealer fails to "substantially comply with an essential and reasonable requirement," but a discriminatory requirement is not "essential" and "reasonable." The appellate court thus upheld the finding that CNH's market share requirement was not "essential" and "reasonable" because it discriminated against small dealers, which received lesser discounts than larger dealers. The court further noted that CNH chose not to terminate some dealerships that failed to meet the market share requirement based on a nonuniform, subjective standard. CNH therefore lacked good cause to terminate Chili.

## SYSTEM CHANGE

### DISTRIBUTION CHANGES PROVIDE BIGGEST RISKS FOR MANUFACTURERS

As we see in some of the cases summarized above, change tends to leave some former distribution partners or would-be competitors on the outside looking in. It is in these situations when disputes, threats, and even litigation can result. In these same situations, therefore, the manufacturer is best served by having clear documentation in its files, having had legal compliance programs in place, having trained its employees how not to violate antitrust laws and other legal boundaries, and having understood and followed rules relating to pricing, exclusivity, and termination.

Changes and the resulting conflicts most frequently arise in the following scenarios:

- The manufacturer starts "selling direct" rather than through intermediaries.
- "Fewer, stronger dealers" is adopted as a business strategy.
- The company believes it can grow market share best through a dedicated sales force it employs rather than through independent sales representatives.
- After a merger or acquisition, the manufacturer consolidates distribution.

In these scenarios, the manufacturer faces both business and legal risks. On the business side, what if existing distributors, dealers, or sales representatives have relationships with end users that allow them to steer business to your competitors' product lines? Legally, what if your soon-to-be-former distribution and sales partners go to lawyers in an attempt to force you to continue those relationships, or, to compensate them for losing access to your lines? What if, heaven forbid, termination of distributors, dealers, or sales representatives brings out claims that you have been engaging in unlawful activity, most commonly alleged to be violations of antitrust laws?

To weigh these risks, manufacturers contemplating distribution changes should first review two basic things: (1) what the contracts they have in place allow and require; and (2) what is mandated by law. Many contracts, and the existing laws in many states, delineate when termination is allowed and on what grounds, how much notice is required, whether inventory must be repurchased, what commissions must be paid to sales representatives upon or after termination, and what rights and obligations the parties have regarding post-termination competition. Intellectual property, such as trademarks, confidential information, and trade secrets, may also be protected.

We will elaborate on these topics in future Distribution Issues of *The GPMemorandum*.

**Along with the attorneys indicated on the next page, summer associates Brandon Kaster, Molly Littman, Caitlin Miles, Jelan Passley, James Thomson, and Pa Nhia Vang all contributed to this issue.**

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