

# The Franchise Memorandum

| By Lathrop GPM

**To: Our Franchise and Distribution Clients and Friends**

**From: Lathrop GPM's Franchise and Distribution Practice Group**

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Welcome to *The Franchise Memorandum by Lathrop GPM*. Periodically, *The Franchise Memorandum* 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 in this issue include terminations, contracts, arbitration, and fiduciary duties.

## Terminations

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### **First Circuit Affirms Unjust Impairment and Termination Claims Against John Deere, Citing Its Failure to Provide Access to Necessary Training and Prior History of Accepting Late Payments**

The First Circuit Court of Appeals recently affirmed a district court's denial of John Deere's post-trial motions for a new trial or for judgment as a matter of law in its favor. *Casco, Inc. v. John Deere Const. & Forestry Co.*, 900 F.3d 1 (1st Cir. 2021). Casco was a reseller of Deere construction equipment in Puerto Rico pursuant to an agreement Casco entered into with Deere in 1986. In 2012, Deere canceled a purchase order from Casco for an excavator that Casco had sold to a construction company. In 2013, Deere terminated the agreement with Casco citing past-due payments and various other defaults. Casco filed suit in federal court in Puerto Rico alleging unjust impairment under Puerto Rico's Dealer Protection Act based on Deere's cancellation of the 2012 purchase order, and also alleging unjust termination of the agreement. The jury found for Casco on both claims. Deere filed a motion for judgment as a matter of law on the termination claim and a motion for a new trial on both claims. The district court denied both motions.

In its opinion, the First Circuit affirmed both rulings. Regarding the unjust impairment claim, the court found that, even though Casco's employees had not completed all the required training to be authorized to sell excavators, the jury had been presented with enough evidence showing Deere had not adequately provided access to said training. Because the jury properly weighed the competing evidence, it was reasonable that they could have come to such a conclusion. Concerning the unjust termination, the jury was presented with evidence of previous instances where Deere had overlooked late payments and the fact that timely payment was not expressly listed in the "Essential Obligation" section of the agreement, as well as evidence that Deere was not happy Casco had developed a relationship with a Deere

competitor. The First Circuit concluded that based on such facts, the jury reasonably found that termination of the agreement based on late payments was unjust.

## **New Jersey Federal Court Grants Summary Judgment for Manufacturer on Unlawful Termination Claim**

A federal court in New Jersey granted summary judgment to a manufacturer who terminated its distributor for widespread fraud. *Mall Chevrolet, Inc. v. General Motors, LLC*, 2021 WL 426193 (D.N.J. Feb. 8, 2021). Mall Chevrolet has operated a Chevrolet dealership since 1986 and, as part of that business, performed fleet warranty repairs. General Motors established the standards and procedures for the warranty repairs to be performed by Mall, as well as the reimbursement procedure. In May 2017, GM's review of Mall's warranty reimbursement claims uncovered \$672,176.59 in unsubstantiated warranty claims. GM terminated Mall after the dealer was unable to produce documentation to back up these claims. Mall responded by suing GM for unlawful termination under the New Jersey Franchise Practices Act (NJFPA), adding claims that GM imposed unreasonable standards of performance and that its audit was a breach of the covenant of good faith and fair dealing. Mall also challenged the chargebacks GM processed following its review to recoup the amounts it paid Mall for the fraudulent warranty claims and asserted that GM owed Mall payment for other repairs. The parties cross-moved for summary judgment, primarily concerning the wrongfulness of the termination and the evidentiary basis for Mall's damages claims.

The court granted GM summary judgment regarding each of these issues. It held that, even if there were small factual disputes about individual repair claims, there was no real dispute that Mall had submitted a significant number of fraudulent requests for warranty reimbursement. The court rejected Mall's arguments that the NJFPA requires that the franchisee's conduct be intentional and knowing or involve the franchisee's principal before termination can be justified. It also rejected Mall's argument that GM could only justify its termination with the evidence it possessed at the time of termination. The court also granted GM summary judgment on Mall's claims for damages due to lack of evidence. The court excluded Mall's only evidence supporting compensatory damages, an affidavit from its principal that Mall attached to its opposition to GM's summary judgment motion. Since the NJFPA only permits punitive damages if compensatory damages are proven, this disposed of all of Mall's damages claims and essentially all of its complaint, excepting only its claim for a declaration that GM's chargebacks violate the NJFPA, which was allowed to proceed to a non-jury trial.

## **Maryland Court Holds Sale of Beer Distributor's Parent Company Not Enough to Trigger Distributor's Right to Terminate Distributorship Agreement Without Good Cause Under State Law**

A state court of appeals in Maryland recently held that the sale of Pabst Brewing's parent company and a change in Pabst's corporate structure made neither the new parent nor Pabst a "successor beer manufacturer" such that Pabst could terminate a distributorship agreement without cause under the Maryland Beer Franchise Fair Dealing Act (BFFDA). *Frederick P. Winner, Ltd v. Pabst Brewing Co.*, 245 A.3d 242 (Md. Ct. Spec. App. 2021). In November 2014, Blue Ribbon, LLC purchased Pabst Brewing's parent company, and Pabst restructured from a Delaware corporation to a Delaware LLC. In March 2015, based on the sale and restructuring, Pabst notified Winner of its intent to terminate the parties' distributorship agreement, citing the exception to the BFFDA's good cause for termination requirement for

a successor beer manufacturer. Winner filed a lawsuit challenging the termination. The circuit court granted summary judgment for Pabst, holding the termination was allowed because Blue Ribbon's ownership and control over Pabst after the sale made it a successor beer manufacturer. Winner appealed and the special court of appeals reversed.

The BFFDA defines a "successor beer manufacturer" to include "a person or license holder who replaces a beer manufacturer with the right to sell, distribute, or import a brand of beer." The special court of appeals rejected Pabst's and the circuit court's control-based test for interpreting the definition — there was no dispute that Blue Ribbon now "controlled" Pabst through its stock ownership. Instead, the court focused on whether Blue Ribbon, or the new Pabst LLC, had actually "replaced" Pabst. The court found that Pabst had not been replaced because the sale was strictly a stock sale, not an asset sale, and Pabst retained its brands, trademarks, and contracts. Moreover, though Pabst converted to an LLC, it informed the state of Maryland that it would continue operating under the same Employer Identification Number, that no new entity had been formed, and that "all basic business functions [would] continue uninterrupted." The court of appeals concluded that though a change in ownership and control had occurred, "the entity with the right to sell, distribute, or import the brands of beer remained the same, and, therefore, was not replaced."

## Contracts

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### First Circuit Upholds an Implied Contract Between a Manufacturer and a Distributer

The First Circuit Court of Appeals has upheld a finding that an implied contract was formed between a manufacturer and a distributor, and an award of damages to the distributor based on that contract. *Primarque Prod. Co. v. Williams West & Witts Prod. Co.*, 988 F.3d 26 (1st Cir. 2021). For almost 40 years, Williams West & Witts Products Co. (WWW) and Primarque Products Co. had a manufacturer-distributor relationship for the sale of soup base products. Except for a six-year period, the relationship was not governed by a written contract — WWW simply manufactured products in response to purchase orders from Primarque and delivered those products to Primarque's customers. In 2015, Primarque began purchasing more soup base products from WWW's competitors, resulting in a decrease in its purchases from WWW. Two days after learning of this, WWW terminated its relationship with Primarque and began selling products directly to Primarque's former customers. Primarque sued WWW, alleging, among other things, breach of contract and tortious interference with business relations. At trial, the jury awarded Primarque damages on both of those claims, and the court denied WWW's post-trial motions for judgment as a matter of law.

The central issue on appeal was whether Primarque had an enforceable contract and whether that contract was subject to a Massachusetts' statute requiring reasonable notice before termination of contracts. The court of appeals found that Primarque had sufficiently shown that an enforceable contract had been implied-in-fact by the parties' course of conduct, despite the lack of an oral or written agreement and that the Massachusetts statute requiring reasonable notice of termination applied to that contract. Accordingly, the First Circuit affirmed the trial court's award of damages to Primarque.

## Michigan Federal Court Dismisses Claims that Brewer Breached Requirements Contract by Reducing Purchases to Zero

A federal court in Michigan recently dismissed a distributor's four-count complaint alleging that a brewer's drastic reduction of beer sales was in breach of a requirements contract. *Silver Foam Distr. v. Labatt Brewing Trading Co.*, 2021 WL 859043 (E.D. Mich. Mar. 8, 2021). Defendant SABMiller Canada (Miller) entered into a five-year service agreement with Plaintiff Silver Foam Distributing Company (Silver Foam) to ship Miller's beer from the United States to Canada. Silver Foam spent roughly \$1 million on equipment, hired and trained employees, and signed a lease in order to perform under the agreement — a significant investment for which certain protections were built into the contract in case of termination. The parties operated under the agreement for approximately three years until Miller's parent company sold the beer brands being shipped under the agreement. As a result, Miller stopped using Silver Foam's shipping services. Silver Foam brought suit alleging that the service agreement was a requirements contract that required Miller to perform in good faith, and that Miller breached the agreement because it acted in bad faith when it reduced its requirement to zero. The court assumed without deciding that the agreement was a requirements contract but concluded that Miller did not act in bad faith because the sale of the brands was a legitimate business decision, and the court noted a well-established rule on good faith in the context of a requirements contract that allowed a business to drastically reduce its purchases, even to zero. The court also reasoned that Silver Foam's significant investment in equipment for this contract did not impact the good-faith standard because Silver Foam had been free to negotiate for a minimum monthly purchase, but the agreement lacked any such requirement.

The court also dismissed the remaining counts. Count II alleged that Miller terminated the agreement because it rendered itself unable to perform under the agreement yet failed to provide written notice of termination. The court determined that a written notice was required to terminate the agreement but that Miller had not terminated the agreement by setting its requirement to zero. As to Count III, the court rejected Silver Foam's argument that Miller breached the agreement by failing to pay amounts provided by the penalty clause. The court determined that, because the contract was never actually terminated, the penalty clauses were never triggered. Lastly, the court dismissed a claim for promissory estoppel because it concluded that the parties had an enforceable agreement that governed the dispute, and an enforceable agreement barred a promissory estoppel claim.

## Arbitration

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### California Federal Court Rejects Request to Disqualify JAMS from Conducting Arbitration

A federal court in California rejected City Beverages' request to disqualify JAMS from arbitrating its contractual dispute with Monster Energy. *Monster Energy Co. v. City Beverages, LLC*, 2021 WL 650275 (C.D. Cal. Feb. 17, 2021). In arbitration conducted by JAMS, City Beverages (d/b/a Olympic Eagle Distributing) challenged the validity of Monster's termination of a distribution agreement under Washington's franchise law. The arbitrator found the franchise law inapplicable, found the termination was valid, and awarded Monster \$3 million in attorneys' fees. The Ninth Circuit Court of Appeals vacated the award based on the arbitrator's failure to disclose his ownership interest in JAMS given JAMS had

administered 97 arbitrations for Monster over the past five years. On remand, Olympic then sought to disqualify JAMS from conducting the arbitration altogether.

In its motion to compel arbitration before an alternative arbitration organization, Olympic contended the submission by JAMS of amicus briefs before the Ninth Circuit in support of Monster “created reasonable doubt about its partiality” and argued, therefore, that the contractual provision requiring arbitration be administered by JAMS was unconscionable. The district court rejected this conclusion as the briefs submitted by JAMS did not address the underlying dispute between Olympic and Monster; rather, they addressed the Ninth Circuit’s understanding of arbitration disclosure requirements. The court found no reason to take the “drastic step of disqualifying every single JAMS arbitrator,” and concluded JAMS has sufficient safeguards in place to maintain an impartial forum.

## Fiduciary Duty

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### Ohio Federal Court Finds Distributor Adequately Alleged Breach of Fiduciary Duty Claim Against Manufacturer

A federal court in Ohio recently held that a distributor adequately alleged the existence of a fiduciary relationship with a manufacturer. *Shepard and Assocs., Inc. v. Lokring Tech., LLC*, 2021 WL 1061893 (N.D. Ohio Mar. 19, 2021). Shepard and Associates was a distributor of Lokring products, which are patented weld-equivalent pipe and tube fittings, in the southwest United States. The distributor was initially owned by an individual named Joe Shepard, and was subsequently sold to his son, Brad Shepard, when Joe Shepard established a new distributor in the southeast United States. In connection with the transfer of the distributor to the son, Lokring structured the transaction and prepared the documents for the transaction. Lokring further assured the son that it would continue to work with him as long as the distributor performed well. The parties’ relationship subsequently soured and, despite the distributor’s allegedly strong performance, Lokring terminated it. The distributor sued, alleging, among other claims, that Lokring breached its fiduciary duty by terminating the relationship.

Lokring moved to dismiss, arguing that no fiduciary relationship existed as they were merely parties to a distributor agreement, which expressly stated the distributor’s relationship as an independent contractor. The distributor argued that, based on Lokring’s involvement in the transfer of the distributor from father to son, its assurances that it would honor the son’s company as long as it performed well, and Lokring’s alleged total control of the distributor under the distributor agreement, the parties’ relationship arose to a fiduciary relationship. The court agreed with the distributor. The court held that various provisions of the distributor agreement, which granted Lokring “immense” control over many aspects of the distributor’s business and required numerous disclosures by the distributor to Lokring, including detailed customer and financial information, made the relationship between the parties more akin to a fiduciary relationship. The court further reasoned that while the distributor agreement labeled the distributor as an independent contractor, the label was not dispositive.

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