The Franchise Memorandum | By Lathrop GPM

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

From: **Lathrop GPM's Franchise and Distribution Practice Group**
Maisa Jean Frank, Editor of *The Franchise Memorandum by Lathrop GPM*
Richard C. Landon, Editor of *The Franchise Memorandum by Lathrop GPM*

Date: **August 5, 2020 — Issue # 256 (Distribution Issue)**

Welcome to *The Franchise Memorandum by Lathrop GPM*, formerly known as *The GPMemorandum*. 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 franchise associations, good faith and fair dealing, and antitrust.

Given the widespread and evolving impact of the COVID-19 pandemic, this issue also includes recent developments and resources related to COVID-19.

Franchise Associations

Third Circuit Reverses Dismissal of Franchise Association Claims, Concluding it Did Not Lack Standing

The Third Circuit Court of Appeals reversed a judgment dismissing claims brought by the New Jersey Coalition of Automotive Retailers against Mazda Motor of America under the New Jersey Franchise Practices Act. *N.J. Coal. of Auto. Retailers, Inc. v. Mazda Motor of Am., Inc.*, 957 F.3d 390 (3d Cir. 2020). In the underlying action, the Coalition (a trade association whose members consist of franchised new car dealerships in New Jersey, including 16 Mazda dealers) alleged Mazda's incentive program for its franchised dealers violates the New Jersey Franchise Practices Act in that it creates unfair competitive advantages for dealers who qualify for incentives. Based on a tiered system, Mazda's incentive program provides vehicle discounts and rebates to dealers that make certain capital investments in their facilities and/or exclusively sell Mazda vehicles. Three of the 16 Mazda dealers qualified for the highest tier of incentives and eight others qualified for some lower tier of incentives. The trial court granted Mazda's motion to dismiss on the grounds that the Coalition lacked association standing to bring the action because only five of the 16 Mazda dealers would benefit from the lawsuit. The Third Circuit reversed the judgment reasoning the trial court construed the Coalition's complaint too narrowly.

The trial court had concluded that, if the Coalition was granted the relief, 11 of the 16 Mazda dealers would lose the incentives they currently enjoy under the incentive program; therefore, the lawsuit is in conflict with the interests of those 11 dealers. Thus, the trial court held that the Coalition does not meet association standing requirements mandating an action to be in the interest of the majority of a trade association's members. The Third Circuit disagreed, finding it plausible that some members of the Coalition currently receiving incentives from Mazda may not be in favor of the incentive program. The

Third Circuit posited that (1) the eight dealers receiving a lower tier of incentives may be opposed to the three dealers receiving the highest tier of incentives; and (2) many of the dealers, even those receiving the highest tier of incentives, may be opposed to the financial commitments required under the incentive program, but nevertheless feel pressured to participate in order to compete. Further, although Mazda provided declarations of five dealers in opposition to the lawsuit, the Third Circuit noted that five does not constitute a majority of the 16 Mazda dealers. In reversing the trial court's dismissal, the Third Circuit explicitly noted it was expressing no opinion as to the merits of this case or whether the complaint sufficiently stated a valid claim; rather, it was simply reversing the lower court's dismissal as to standing and remanding for further proceedings.

Duty of Good Faith and Fair Dealing

Seventh Circuit Affirms Ruling that Distributor Breached Agreement by Failing to Secure Government Contract, but that Force Majeure Excused the Breach

The Seventh Circuit Court of Appeals affirmed an Indiana federal court's decision strictly interpreting a distribution contract according to its terms and limiting the application of the duty of good faith and fair dealing implied into such contracts by the Indiana Commercial Code. *Acheron Med. Supply, LLC v. Cook Med. Inc.*, 958 F.3d 637 (7th Cir. 2020). Cook, a manufacturer of medical devices and products, contracted with Acheron, a distributor experienced in selling to the Veterans Administration and Department of Defense, to serve as Cook's distributor to those entities. The contract required Acheron to obtain a Federal Supply Schedule for VA sales. The VA requested an audit of Cook's sales records to confirm the reasonableness of Acheron's prices before issuing an FSS, but Cook refused. Cook also refused to deactivate its DoD Distribution and Pricing Agreement, thereby preventing Acheron from selling Cook products to the DoD. Nevertheless, a Cook executive told Acheron the contract remained in place before Cook terminated it for Acheron's failure to secure an FSS. When the parties sued each other for breach, the district court found Cook was not obligated to submit to the VA audit or deactivate its Pricing Agreement. It also found that Acheron's breach in failing to obtain an FSS was excused by the contract's force majeure provision. Each party appealed, to no avail.

The Seventh Circuit rejected Acheron's appeal based on Indiana contract law providing that unambiguous contracts are enforced as written. The contract did not require Cook to submit to the VA audit or deactivate its Pricing Agreement. Similarly, the implied duty of good faith and fair dealing could not be used to create obligations not present in the contract. Further, Acheron obtained the contract based on its government contracting experience and "should have known better" than to agree to a contract omitting such requirements. The court then held that Cook could not recover damages for Acheron's failure to obtain an FSS because of the contract's force majeure clause, which excused defaults caused by an act of the government or agency. Because the VA's denial of Acheron's FSS application was outside of the parties' anticipation and Acheron's control, it qualified as a force majeure event. In the remainder of its decision, the court held that Cook had no obligation to eliminate the force majeure event by submitting to the VA's audit. No federal regulations that could be incorporated into the contract by implication required Cook, a manufacturer, to submit to the VA audit. And Acheron could not argue that Cook prevented its performance, because Acheron's obtaining an FSS was not a condition precedent to Cook's performance, but an integral part of the agreement. Thus, the appellate court affirmed the lower court's decision.

Tortious Interference

Third Circuit Concludes Franchisor Did Not Interfere with an Agreement to Open a New Car Dealership by Revoking Approval for Relocation

In another case from the Third Circuit, the appellate court affirmed a lower court's decision to grant a franchisor's motion for summary judgment. *Audi of Am. v. Bronsberg & Hughes Pontiac, Inc.*, 2020 WL 2988888 (3d Cir. June 4, 2020). Audi of America and Wyoming Valley Motors (WVM) were parties to a 1997 franchise agreement that permitted WVM to operate a location-specific Audi dealership. In 2011, Audi unveiled a plan to convert all franchised locations to exclusive dealerships, with a six-year transition period. To comply with these new requirements, WVM purchased real estate near the existing dealership to relocate the Audi franchised business. Around the same time, WVM and a third party company, Napleton, entered into an asset purchase agreement whereby WVM would sell its entire business, including the Audi franchised business, to Napleton. While WVM requested Audi's consent to relocate to the new location, it failed to notify Audi of the proposed transfer. Audi granted its preliminary approval for relocation, but retained the right to revoke its approval if WVM failed to perform the terms and conditions of the franchise agreement. Once WVM received Audi's approval, it disclosed the proposed sale and transfer to Napleton. Audi requested additional details, but WVM and Napleton failed to disclose integral information, which eventually resulted in Audi seeking and obtaining an injunction to stop WVM from transferring the franchised business. Audi ultimately refused to allow the transfer, and Napleton filed various claims against Audi, including tortious interference. The district court granted summary judgment on these claims and Napleton then appealed.

The appellate court's review focused on whether Audi's conduct was privileged or justified. As the court stated, the issue was whether Audi's conduct was "sanctioned by the rules of the game which society has adopted." The court noted that substantial deference must be given to Audi if its actions protected "an existing legitimate business concern." First, the court affirmed that Audi had legitimate business concerns related to the franchise, its value, and its ownership, and that Audi was not merely punishing Napleton for its past role in a diesel emissions lawsuit. Second, the court affirmed that Audi had only revoked its consent to the relocation agreement once Audi learned about the undisclosed transfer of the real estate. "On those facts, there is no evidence on which 'a reasonable jury could return a verdict for the nonmoving party,' making summary judgment for Audi proper."

Antitrust

New Jersey Federal Court Denies Prospective Distributor's Group Boycott and Monopolization Claims Against Existing Distributor

A federal court in New Jersey recently denied antitrust claims brought by a prospective baker and distributor of Dunkin' Donuts products against an existing distributor. *Central Jersey, CML v. Patel*, 2020 WL 2840125 (D.N.J. May 31, 2020). Central Jersey, CML sought to open a baking and distribution facility for nearby Dunkin' Donuts stores. In pursuit of its efforts, it obtained conditional approval for $18.9 million in New Jersey State tax credits. Also in pursuit of its efforts, it sought the financial backing of the defendants — members of another New Jersey-based Dunkin' baking and distribution facility. However, the defendants decided not to become involved with Central CML and entered into a corporate resolution to that effect. The defendants also sent Dunkin' a letter informing it that, notwithstanding Central CML's representations to the contrary, the defendants were not involved with Central CML. Central CML

ultimately lost its tax credits after it failed to provide to the state required documents. And it never opened its facility. Instead, based on the defendants' corporate resolution and letter to Dunkin', Central CML sued the defendants for, among other things, a group boycott and attempted monopolization of relevant market in violation of the Sherman Act, as well as tortious interference and civil conspiracy. Both parties filed for summary judgment. The court denied Central CML's motion and granted the defendants', dismissing Central CML's claims with prejudice.

As a preliminary matter, the court determined that Central CML's antitrust claims were governed by the "rule of reason" standard, under which a court must assess whether alleged anticompetitive conduct imposes an unreasonable restraint on competition, rather than by the "*per se*" rule, under which alleged anticompetitive conduct is deemed necessarily illegal. In reaching its conclusion, the court observed that application of the *per se* rule is limited to agreements between direct competitors, and that the defendants were not competitors but were instead members of the same limited liability company. Next, in denying Central CML's antitrust claims, the court held that it had failed to present evidence that the defendants possessed a monopoly in the relevant market, or attempted to establish such a monopoly. The court rejected the argument that the defendants' letter to Dunkin' demonstrated an attempted monopolization, observing that the letter merely sought to clarify the defendants' lack of involvement with Central CML and never demanded that Dunkin' deny Central CML approval. Furthermore, the court held that Central CML failed to prove any causal link between its alleged injury and the defendants' actions as required by antitrust law, because the defendants had no control over whether Central CML was approved by Dunkin' and the record evidence indicated that Central CML lost its tax credits for reasons unrelated to any conduct by the defendants. The court also dismissed Central CML's tortious interference claim because it failed to show malicious conduct by the defendants or that, for the reasons stated above, the defendants caused whatever harm Central CML suffered. Finally, the court dismissed Central CML's conspiracy claim because the claim required an underlying wrong and the court had already dismissed the defendants' alleged wrongful acts.

Choice of Law

Washington Federal Court Rejects Wisconsin Distributor's Request to Apply Wisconsin's Fair Dealership Law

A federal court in Washington held that a distributor failed to demonstrate that Wisconsin law, particularly the Wisconsin Fair Dealership Law (WFDL), should apply to a distribution agreement that specified that the agreement is to be governed by the laws of the State of Washington. *ACD Distrib., LLC v. Wizards of the Coast, LLC*, 2020 WL 3266196 (W.D. Wash. June 17, 2020). ACD, located in Wisconsin, and Wizards of the Coast (WOTC), located in Washington, entered into a distribution agreement that granted ACD the right to distribute WOTC's gaming products in Wisconsin. At the end of the term, WOTC elected not to renew the distribution agreement and did not provide ACD with a reason for its decision. The agreement's governing law and forum selection clause both specified Washington. ACD commenced an action alleging that WOTC's failure to renew the agreement violated the WFDL and breached a duty of good faith and fair dealing. WOTC filed a motion seeking a ruling that Washington, not Wisconsin law, applied, and therefore it was entitled to a partial judgment on the pleadings with respect to the WFDL claim.

The court grated WOTC's motion on the grounds that ACD failed to meet its burden to demonstrate that Wisconsin has a materially greater interest in having its law applied over Washington's. The parties

agreed that there is a real conflict between Washington and Wisconsin law because Washington does not have a law prohibiting a dealership from failing to renew a distribution agreement without good cause, unlike the WFDL. Therefore, ACD had to satisfy a three-pronged test in order to have Wisconsin law apply and to avoid the choice of law provision in the agreement. The court held that ACD failed to demonstrate that Wisconsin had a "materially greater interest," reasoning that ACD failed to establish that applying Washington law would contravene Wisconsin's intent of protecting dealers against unfair treatment, especially since ACD agreed that Washington law would apply. Thus, the court enforced the Washington choice of law provision, granted WOTC's motion, and dismissed the WFDL claim.

Fraud/Misrepresentation

Federal Court in New York Rules Supplier Did Not Have a Duty to Disclose in Advance its Plans to Change its Distribution System to its Distribution Partners

A federal court in New York recently held that a supplier did not have a duty to disclose its business plans to its distribution partners before it changed its distribution system. *Aaronson v. Kellogg Co.*, 2020 WL 2489087 (E.D.N.Y. May 14, 2020). Since 2000, Kellogg, a manufacturer of snack foods, had distributed its products through a Direct Store Delivery Distributor (DSDD) system, which relied on master distributors and sub-distributors for delivery and distribution of its products. In 2017, as part of a cost-savings initiative, Kellogg changed its distribution model and eliminated the DSDD system, which resulted in the elimination of a number of sub-distributors. A group of affected sub-distributors sued Kellogg alleging that Kellogg and its direct distributor, W.M. Brown, misrepresented their distribution intentions to the sub-distributors.

The sub-distributors asserted claims for breach of fiduciary duty, constructive fraud, and negligent misrepresentation based on their contention that Kellogg had a secret plan to change its distribution system, that Kellogg had an obligation to disclose the existence of that plan to them, and Kellogg's failure to do so was actionable. Kellogg moved to dismiss the claims and the court agreed, holding the claims failed as a matter of law for several reasons. First, the court found that the existence of a secret plan was not supported by plausible, nonspeculative allegations. Second, the court held that several sub-distributors failed to allege any representations made to them by Kellogg. Third, the court held that the other sub-distributors failed to make any allegations that plausibly suggested a fiduciary, confidential, or special relationship between them and Kellogg such that a duty to disclose its distribution plans would arise. Fourth, the court held that the sub-distributors failed to make plausible allegations that the alleged statements made by Kellogg were false or that the sub-distributors relied on them to their detriment. The sub-distributors also asserted several quasi-contract claims for quantum meruit and unjust enrichment, which the court also dismissed based on the existence of valid, written agreements between the sub-distributors and the master distributor.

Choice of Forum/Venue

Michigan Federal Court Concludes Forum Selection Clause Is Enforceable Despite Absence of the Word "Venue"

A federal court granted a motion to transfer venue of a distributor's claims from the Eastern District of Michigan to the Central District of California. *Complete Med. Sales, Inc. v. Genoray Am., Inc.*, 2020 WL

4013306 (E.D. Mich. July 16, 2020). Complete Medical Services had entered into a distribution agreement with Genoray America to sell Genoray America's manufactured medical diagnostic equipment. The parties also entered into a dealer policy which, among other things, specified that "any case of dispute or legal cases will follow the law of the state of California, specifically under jurisdiction of [Defendant's] office at Orange, CA." After Complete Medical Sales sued Genoray America for breach of contract and related claims, Genoray America sought to transfer the case from Michigan federal court to California federal court pursuant to the dealer policy between the parties.

The court's reasoning for granting the transfer turned on the principle that forum selection clauses generally are given "controlling weight" with few exceptions. Complete Medical Services argued that because the dealer policy did not include the word "venue" and only used the word "jurisdiction" that the provision was invalid, yet courts routinely enforce forum selection clauses which contain the word "jurisdiction" as opposed to "venue." The clause as a whole contained mandatory language, and the court indicated that the language "any case of dispute or legal cases . . . will follow under Jurisdiction of Defendant's office at Orange," provides exclusive jurisdiction for disputes to be litigated in Orange. The precision of the location, Orange, was unambiguous with regard to the appropriate venue. Noting that commercial forum selection clauses between for-profit businesses are valid on their face, the court ordered the case to be transferred to California.

COVID-19 Pandemic

Update on DOJ Expedited Review of Business Conduct Related to COVID-19

As previously reported in Issue 252 of *The Franchise Memorandum*, the DOJ's Antitrust Division and the FTC's Bureau of Competition recently issued a joint statement regarding review of business collaborations in the fight against COVID-19, announcing a plan to expedite the Business Review Process for potential antitrust risk. A review of the recent opinions issued under this new process, and lessons that can be learned from the enforcement approach in those reviews, can be found here.

Other COVID-19 Resources for Franchisors and Distributors

Lathrop GPM continues to provide clients with alerts, articles, and other resources to help clients navigate important legal information regarding the COVID-19 pandemic. Some of the following may be of particular interest to franchisors and distribution-based businesses:

- **IP Alert**: USPTO Implements COVID-19 Prioritized Examination Program for Trademarks and Service Marks by Tucker Griffith
- **Franchise Alert**: Four Key Takeaways from the NASAA & Washington Commentaries on COVID-19 Disclosures by Hannah Holloran Fotsch and Mark Kirsch

These updates and resources from Lathrop GPM's cross-disciplinary team are available at the **Lathrop GPM COVID-19 Client Resource website.**

Lathrop GPM Franchise and Distribution Attorneys:

Liz Dillon (Practice Group Leader)	612.632.3284	* Craig P. Miller	612.632.3258
* Eli Bensignor	612.632.3438	Bruce W. Mooty	612.632.3333
Sandra Yaeger Bodeau	612.632.3211	Katherine R. Morrison	202.295.2237
Phillip W. Bohl	612.632.3019	Marilyn E. Nathanson	314.613.2503
* Samuel A. Butler	202.295.2246	Lauren O'Neil Funseth	612.632.3077
Michael A. Clithero	314.613.2848	* Thomas A. Pacheco	202.295.2240
Emilie Eschbacher	314.613.2839	Ryan R. Palmer	612.632.3013
Ashley Bennett Ewald	612.632.3449	Kirk Reilly	612.632.3305
John Fitzgerald	612.632.3064	Eric R. Riess	314.613.2504
* Hannah Holloran Fotsch	612.632.3340	* Justin L. Sallis	202.295.2223
* Maisa Jean Frank	202.295.2209	Max J. Schott, II	612.632.3327
* Alicia M. Goedde (Kerr)	314.613.2821	* Frank J. Sciremammano	202.295.2232
* Michael R. Gray	612.632.3078	* Michael L. Sturm	202.295.2241
Mark Kirsch	202.295.2229	Erica L. Tokar	202.295.2239
Sheldon H. Klein	202.295.2215	Stephen J. Vaughan	202.295.2208
* Peter J. Klarfeld	202.295.2226	* James A. Wahl	612.632.3425
Gaylen L. Knack	612.632.3217	Eric L. Yaffe	202.295.2222
* Richard C. Landon	612.632.3429	Robert Zisk	202.295.2202
Mark S. Mathison	612.632.3247	Carl E. Zwisler	202.295.2225

**Wrote or edited articles for this issue*

Lathrop GPM LLP Offices:

Boston | Boulder | Chicago | Dallas | Denver | Fargo | Jefferson City | Kansas City | Los Angeles | Minneapolis | Overland Park | St. Cloud | St. Louis | Washington, D.C.

Email us at: **franchise@lathropgpm.com**
Follow us on Twitter: **@LathropGPMFran**

For more information on our Franchise and Distribution practice and for recent back issues of this publication, visit the Franchise and Distribution Practice Group at **https://www.lathropgpm.com/services-practices-Franchise-Distribution.html**.

On January 1, 2020, Gray Plant Mooty and Lathrop Gage combined to become Lathrop GPM LLP.