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*, 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 contract claims, preliminary injunctions, and terminations.

Contracts

Second Circuit Affirms Dismissal of Distributor's Breach of Contract Claims

The Second Circuit Court of Appeals recently affirmed a lower court's dismissal of a distributor's breach of contract claims because the contract was terminable at will and the manufacturer had no duty to protect the distributor from competition. *Compania Embotelladora Del Pacifico, S.A. v. Pepsi Cola Company*, 976 F.3d 239 (2d Cir. Sept. 29, 2020). In 1952, PepsiCo and Compania Embotelladora Del Pacifico, S.A. (CEPSA) entered into an exclusive bottler agreement (EBA) granting CEPSA the exclusive right to bottle and distribute Pepsi Cola in a protected territory in parts of Peru. PepsiCo agreed that so long as the EBA was in effect, it would not appoint another bottler to service the protected territory. The EBA had no expiration date, but did permit PepsiCo to terminate it for specific defaults, including breach of the EBA or insolvency. The parties had a successful relationship until the 1990s when CEPSA encountered financial hardship, including the inability to pay PepsiCo. In August 1998, one of CEPSA's creditors filed an insolvency petition. In March 1999, PepsiCo sent CEPSA a notice of termination, citing multiple breaches, including CEPSA's insolvency. In October 2000, CEPSA sued PepsiCo in a federal court in New York, alleging wrongful termination and failure to protect CEPSA from third parties transshipping Pepsi products into the protected territory. Years of litigation ensued and, in October 2008, CEPSA filed an amended complaint alleging two additional tort claims, which the district court eventually dismissed along with CEPSA's wrongful termination claim.

The court later granted a motion for summary judgment by PepsiCo on the transshipment claim because CEPSA failed to prove damages and PepsiCo did not have a contractual duty to protect CEPSA from third-party transshipment into the protected territory. The court further rejected CEPSA's proposition that PepsiCo had a duty to protect it based on the implied covenant of good faith and fair dealing. CEPSA appealed the dismissal of its wrongful termination claim and its breach of contract claim.

Applying a *de novo* standard, the Second Circuit eventually affirmed the lower court's rulings. With respect to CEPSA's wrongful termination claim, under New York law a "contract of indefinite duration is terminable at will unless the contract expressly and unequivocally states that the parties intended to be perpetually bound." The EBA had no expiration date, and the Second Circuit found no contract language that expressly and unequivocally created a perpetual contract. Therefore, PepsiCo had the right to terminate the EBA and the Second Circuit affirmed dismissal of CEPSA's wrongful termination claim. On the transshipping claim, the Second Circuit found that based on the EBA contract language, PepsiCo's only obligation was to refrain from appointing another bottler to service the protected territory. The EBA did not obligate PepsiCo to police the protected territory on CEPSA's behalf. Because the EBA did not discuss or create such an obligation, the court declined to extend the covenant of good faith and fair dealing to require PepsiCo to police the protected territory. The court found no law at the time the parties entered into the EBA that would create such a duty. Thus, the Second Circuit affirmed the lower court's decisions in favor of PepsiCo.

Michigan Federal Court Concludes Licensing Agent Did Not Have Contractual Right to Royalties in "New" Agreement Between Licensor and Manufacturer

A federal court in Michigan has recently granted Whirlpool Corporation's motion for judgment on the pleadings in a contract dispute with its former licensing agent. *Whirlpool Corp. v. Equity Mgmt., Inc.*, Case No. 1:19-cv-00259 (W.D. Mich. Sept. 30, 2020). Lathrop GPM represented Whirlpool in this dispute. When Whirlpool Corporation acquired the Maytag® brand in 2006, it inherited a third party licensing arrangement with the company Equity Management, Inc. (EMI) in which EMI administered third party licensing agreements with manufacturers using the Maytag® trademark. Whirlpool and EMI agreed in 2006 that EMI would continue to administer Maytag licensing agreements already in place, as well as any "renewals, modifications, or other amendments" of those agreements. When the last of those licensing agreements was set to expire at the end of 2018, Whirlpool informed EMI that it would enter into a new agreement with the licensee to begin in 2019, but without EMI's involvement. In response, EMI withheld royalty payments owed to Whirlpool as a claimed setoff for what it believed to be a breach of contract by Whirlpool.

Whirlpool filed suit seeking declaratory judgment on the interpretation of EMI's contractual rights, as well as breach of contract and conversion of royalty payments. The court granted Whirlpool's motion for judgment on the pleadings on all of its claims, agreeing that Whirlpool's new contract with the licensee was not a "renewal" of the old agreement, and that EMI's contractual right to compensation ended when the old license agreement expired. The court rejected EMI's claim that it had a right to be involved in all future relationships between the parties, and rejected the argument that EMI had a right to hold Whirlpool's royalty payments as a purported setoff of claimed future damages. EMI has appealed the decision to the Sixth Circuit.

California Federal Court Refuses to Dismiss Manufacturer's Breach of Contract Claim Against Distributor but Dismisses Fraud Claim

A federal court in California recently partially granted China-based medical device distributor Belter's motion to dismiss a complaint by U.S.-based device distributor Meditex Capital, and related parties, for breach of contract and fraud, among other claims. *Naghavi v. Belter Health Measurement & Analysis*

Tech. Co., 2020 WL 6150431 (S.D. Cal. Oct. 20, 2020). In May 2017, Belter and Meditex entered into a distribution agreement that granted Belter certain rights to sell Meditex's medical devices in China and contained minimum sales requirements. The parties amended the agreement in August 2018. Meditex subsequently sued Belter and related parties alleging, among other things, that Belter failed to meet the minimum sales requirements and fraudulently entered into the distribution agreement with no intention of performing its contractual duties. Belter moved to dismiss the complaint.

Applying Texas law, the court denied Belter's motion to dismiss the breach of contract claim but granted the motion as to the fraud claim. Belter argued there was no minimum sales requirement to breach because the parties' 2018 amended distribution agreement superseded the 2017 agreement and was silent on minimum sales requirements. The court observed that the 2018 amendment would only supersede the 2017 agreement insofar as the parties made it clear in the 2018 agreement that was their intent. Otherwise, the two agreements were to be interpreted together, and only where provisions conflicted would the later agreement prevail. The court held that Meditex had failed to identify any provision in the August 2018 amendment that expressly superseded, addressed, or otherwise conflicted with the minimum sales requirements in the 2017 agreement. The court also rejected Belter's argument that device approval from the Chinese Food and Drug Administration (CFDA) was a condition precedent to the minimum sales requirement. Observing that conditions precedent are "disfavored" and should not be found unless the contractual language "may be construed no other way," the court found the contractual language concerning CFDA approval was insufficiently definite to demonstrate a condition precedent at the motion to dismiss stage. Finally, in dismissing Meditex's fraud claim, the court held Meditex had failed to allege any facts to show Belter did not intend to perform under the contract at the time of formation. The court also dismissed the fraud claim against Belter's parent company because, though Belter and its parent company shared managers and board members, Meditex had failed to allege any such individuals were acting on behalf of the parent.

Maryland Federal Court Rejects Manufacturer's Motion to Dismiss Distributor's Claims for Breach of Contract and Tortious Interference

A federal court in Maryland denied a manufacturer's motion to dismiss claims for breach of contract and tortious interference brought by a former distributor. *KVC Waffles Ltd. v. New Carbon Co.*, 2020 WL 6204303 (D. Md. Oct. 22, 2020). KVC was the exclusive distributor of New Carbon products in parts of Europe. During the initial term, the parties allegedly executed a revised distribution agreement. During a renewal term of the agreement, New Carbon informed KVC that it could not locate an executed copy of the agreement. New Carbon demanded that KVC agree to certain modifications to the agreement or New Carbon would terminate their relationship. Once KVC rejected the proposed terms, New Carbon sent a notice reiterating that there was no agreement in place and their relationship was terminated. KVC initiated suit against New Carbon alleging breach of contract and tortious interference, and New Carbon filed a motion to dismiss.

The court held that, at the current stage, the court must accept as true that the parties executed the revised agreement, and therefore the parties had a contract. The court rejected New Carbon's argument that the statute of limitations had expired because KVC filed the action more than three years after New Carbon notified KVC that the agreement would be terminated if KVC did not agree to the modified terms. The court decided it could reasonably conclude that KVC was not on notice of the termination, and in turn the alleged breach of contract, until New Carbon sent the notice confirming termination, finding that the prior notice could have been construed as negotiation tactics. The court also rejected New Carbon's argument that the limitation of damages provision in the agreement prohibited KVC from recovering any damages after termination of the agreement, concluding that when the agreement is read on the whole, the limitation of damages provision applies when a party terminates the agreement without breach. Finally, the court granted New Carbon's motion to dismiss KVC's request for punitive damages under the breach of contract claim, but not the tortious interference claims.

Wisconsin Federal Court Enforces Broad Release Language to All Agreements Between Manufacturer and Dealership

A federal court in Wisconsin granted summary judgment to a manufacturer on claims brought against it by its former dealer, holding the claims to be barred by the release language in an assignment agreement the dealer executed when it sold the dealership. *Seattle Powersports, LLC v. Harley-Davidson Motor Co.*, 2020 WL 5531565 (E.D. Wis. Sept. 15, 2020). Plaintiff Seattle Powersports, a former Harley-Davidson dealer, sued Harley for breach of contract and good faith and fair dealing based upon its dissatisfaction with the amount of inventory it was allocated. In response to the lawsuit, Harley contended, among other things, that the release language contained in the assignment agreement executed by the dealer barred the dealer's claims. The agreement, to which Harley was not itself a party, transferred the dealer's rights and obligations under financing agreements, gap insurance policies, and servicing plans it had sold to its customers so that the dealership could be sold without these encumbrances. It also released the dealer's claims against Harley-Davidson Credit Corp. and its affiliates, including those related to the agreement itself "or any other documents" or "related . . . relationships." The dealer contended that this language did not apply to claims brought under the dealer contract. In the alternative, it argued that the release's ambiguity required discovery to access the extrinsic evidence necessary to determine its reach.

The court rejected each of the dealer's arguments. The court held that the release unambiguously applied to claims brought under the dealer contract, as Harley-Davidson Credit Corp. is clearly a Harley affiliate and the dealer contract is closely related to — indeed, a prerequisite for — the assignment agreement. The court found the dealer's interpretation insufficient to show any ambiguity because, if the release were limited to the assignment agreement, the language extending the release to "any other documents" or "related . . . relationships" would have no effect. The court noted that the dealer contract was as closely related to the assignment as any other document or relationship could be. Accordingly, the court granted summary judgment in favor of Harley and denied the dealer's motion for additional discovery.

Terminations

Puerto Rican Federal Court Partially Grants Manufacturer's Motion for Summary Judgment on Wrongful Termination Claim

A federal court in Puerto Rico partially granted a manufacturer's motion for summary judgment, finding a Puerto Rican law that protects local distributors from contract terminations without just cause does not apply to the distributor's operations outside of Puerto Rico, and that the manufacturer had just cause to terminate the distributorship. *M30 Brands, LLC v. Riceland Foods, Inc.*, 2020 WL 6084138 (D.P.R. Oct. 15, 2020). Riceland, an Arkansas rice manufacturer and exporter, terminated its distribution relationship with M30, a Puerto Rican company that distributed Riceland's products in Puerto Rico and the Caribbean. M30 sued, bringing wrongful termination and contract impairment claims. Both parties moved for summary judgment.

M30 argued that Riceland terminated the distributorship without just cause, thereby violating Puerto Rican Law 75, which protects local distributors from contract terminations without just cause. M30 also asserted claims for damages under Law 75 based on its future lost sales in the Virgin Islands. Riceland argued that Law 75 did not apply to M30 because M30 failed to develop a market for Riceland's products in Puerto Rico, and that, even if Law 75 applied, Riceland had just cause to terminate the distributorship because M30 had poor sales performance in Puerto Rico. Riceland also argued that Law 75 does not apply outside of Puerto Rico, so the claims for damages based on sales in the Virgin Islands should be dismissed. The court agreed with Riceland, holding that Law 75 does not apply to markets outside of the geographical boundaries of Puerto Rico, and that Riceland had just cause to terminate the distributorship because M30 had "dismal" sales performance in Puerto Rico and undertook no efforts to promote, market, or otherwise develop a market for Riceland's products in Puerto Rico. Finally, the court held that there was a triable issue of fact concerning M30's claim that Riceland violated Law 75 by impairing its ability to compete in the Puerto Rican rice market by delivering some of its shipments late.

Preliminary Injunctions

Wisconsin Federal Court Preliminarily Enjoins Termination of Exclusive Distributorship

A federal court in Wisconsin recently granted a distributor's motion for a temporary restraining order and a preliminary injunction to enjoin a manufacturer from terminating a longstanding but unwritten exclusive dealership agreement. *Keen Edge Co., Inc. v. Wright Mfg., Inc*., 2020 WL 4926664 (E.D. Wis. Aug. 21, 2020). For over 20 years, Keen Edge enjoyed exclusive rights to sell Wright's products in much of the Midwest. Wright's products accounted for almost 95% of Keen Edge's sales. After a change in Wright's leadership, however, Wright required Keen Edge to implement multiple changes to its business and, a few months later, terminated the relationship without providing specific reasons or an opportunity to cure deficiencies. Keen Edge moved to preliminarily enjoin Wright from terminating the relationship.

In granting injunctive relief, the court found Keen Edge suffered irreparable harm because it would lose 95% of its sales. The court also found that Keen Edge was likely to succeed on the merits of its claim under the Wisconsin Fair Dealership Law. Wright disputed whether the Wisconsin law applied to Keen Edge, which had only one employee based in Wisconsin, but the court found that Keen Edge's inventory was in Wisconsin, Keen Edge operated out of a Wisconsin facility, and Keen Edge put forth 20% of its sales effort into Wisconsin. Similarly, the court found that Keen Edge and Wright had a community of interest given the longstanding relationship. Further, Wright failed to provide the required 90 days' notice, and it failed to show good cause for termination as required. As a result of the dramatic loss of business Keen Edge would experience if Wright terminated the relationship, the court found the equities weighed in favor of issuing the injunction. With limited analysis, the court concluded Keen Edge could succeed on the merits of other similar state law claims, and thus temporarily restrained Wright from the termination of Keen Edge's distributorship and allowed Keen Edge to continue to do business as the exclusive distributor for Wright's products in many parts of the Midwest.

Franchise Year in Review

As the year draws to a close, join *The Franchise Memo by Lathrop GPM* editors Maisa Frank and Richard Landon as they recap some of the most significant decisions and lessons learned in franchise law during the past year. Topics covered in the webinar will include:

- Joint employer standards.
- Injunctive relief for noncompete provisions.
- Issues of arbitrability.
- Application of forum selection clauses.

The panelists will also discuss the impact of the COVID-19 pandemic on franchising and trends to watch for in the coming year.

Date: Tomorrow, December 10, 2020

Time: 12:00 p.m. - 1:00 p.m. CT

Location: Presented via live webinar. This webinar is available for no cost. One hour of CLE credit will be applied for in Minnesota and Missouri.

Register Here

Along with the attorneys on the next page, litigation associates Brad Johnson and Shoshanah Shanes contributed to this issue.

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