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 choice of law, terminations, and arbitration.

Arbitration

Eleventh Circuit Affirms Ruling that Manufacturer Is Not Bound by Agreement to Which It Was Not a Party

The Eleventh Circuit Court of Appeals recently affirmed a ruling that forklift manufacturer Taylor Group could not be compelled to arbitrate a dispute pursuant to an arbitration provision in an agreement to which it was not a party. *Taylor Grp., Inc. v. Indus. Distribs. Int'l Co.*, 2021 WL 2327910 (11th Cir. June 8, 2021). In 1991, Taylor Group entered into a distribution agreement with Taylor Machine Works, Inc., giving Machine Works the right to distribute Taylor Group's forklifts overseas. In 1999, Machine Works entered into a marketing agreement with Industrial Distributors, granting Industrial the right to market Machine Works' products in the Dominican Republic. That agreement contained an arbitration clause. Machine Works terminated the marketing agreement in 2018. Then, in 2019, Taylor Group repurchased Machine Works' international distribution rights. Taylor Group subsequently accused Industrial of trademark infringement and brought suit in federal court in Florida. Industrial, in turn, moved to compel Taylor Group to arbitrate its claims pursuant to the arbitration clause in the marketing agreement. The district court denied Industrial's motion and Industrial appealed, arguing that Taylor Group, though a nonsignatory, could and should be bound by the arbitration clause under the theories of estoppel, third-party beneficiary, agency, and assumption. The Eleventh Circuit disagreed and affirmed the district court.

As a threshold matter, the Eleventh Circuit held that it was proper for the district court to determine the arbitrability of the parties' dispute. The question of arbitrability is one for the court absent "clear and unmistakable evidence" to the contrary and, as a nonsignatory, Taylor Group had plainly not agreed to delegate the question of arbitrability to an arbitrator. Moving to the substance of the motion to compel, the court acknowledged that while a nonsignatory may be estopped from avoiding an agreement to arbitrate if its claims arise from, or it directly benefited from, the underlying contract obligations, Taylor Group's claims were not related to the marketing agreement (which had been terminated over a year before the

claims arose), and it did not directly benefit from the agreement simply by making money from it. The court rejected Industrial's third-party beneficiary argument for the same reasons. It also held that Machine Works was not acting as Taylor Group's agent when it entered into the marketing agreement because the distribution agreement between the parties made it clear that no agency relationship existed. The court noted that Taylor Group did not control Machine Works and the marketing agreement made it clear that Machine Works was acting on its own behalf. Finally, the court rejected Industrial's argument that Taylor Group had assumed the marketing agreement when it purchased certain of Machine Works' assets because the asset purchase did not include the marketing agreement; the marketing agreement had been terminated by the time Taylor Group purchased the assets; and, in any event, the marketing agreement made it clear that it could not be assigned.

Choice of Law

Sixth Circuit Affirms Michigan Federal Court's Decision to Exercise Jurisdiction and Apply Michigan Law

The Sixth Circuit Court of Appeals affirmed a Michigan federal court's finding that Michigan was a proper forum and Michigan law applied to dealer agreements between a Michigan manufacturer and a dealer in the Dominican Republic. *S2 Yachts, Inc. v. ERH Marine Corp.*, 2021 WL 1943371 (6th Cir. May 14, 2021). S2 Yachts, a Michigan marine-vessel manufacturer, entered into dealer agreements that contained Michigan choice of law provisions with ERH Marine Corp., a marine dealer and maintenance provider who does business in the Dominican Republic. Over time, the parties signed additional dealer agreements but, in January 2018, S2 Yachts notified ERH Marine that it did not plan to renew the dealer agreements when they expired in July 2018. ERH Marine disputed the termination, arguing that under Dominican Republic law S2 Yachts was required to demonstrate "just cause" for the nonrenewal. However, under Michigan law, "just cause" was not required. S2 Yachts filed suit in the Western District of Michigan seeking a declaratory judgement that it complied with all its obligations under the dealer agreements. About one month later, ERH Marine filed suit in the Dominican Republic and moved to dismiss the Michigan action, arguing the Michigan court should not exercise its jurisdiction in this matter and instead should allow the action to proceed only in the Dominican Republic. ERH Marine also argued the court should apply Dominican Republic law to the dispute. Finding Michigan law controlled the dispute and Michigan was a proper venue, the district court granted summary judgment for S2 Yachts.

The Sixth Circuit affirmed. With regard to the choice of law issue, ERH Marine argued that the Michigan court should apply Dominican Republic law citing fundamental public policy factors and Dominican Republic Law 173, which governs agents and distributors. The Sixth Circuit agreed with the district court's determination that Law 173 was not applicable under the Dominican Republic-Central America-United States Free Trade Agreement. Further, applying Michigan's choice of law rules, the court found that public policy did not favor applying Dominican Republic law because it did not differ significantly from Michigan law, which was chosen in the agreements. The court also found the district court properly exercised jurisdiction over the dispute. ERH Marine argued that Michigan was not a convenient forum and the Dominican Republic was better suited to hear the dispute, but the appellate court disagreed, stating that S2 Yachts properly brought the action in Michigan pursuant to a valid forum selection clause. Further, public policy factors weighed in favor of the Michigan court exercising jurisdiction because, although the controversy was localized to the Dominican Republic, this alone did not offset other public interest factors such as a lack of administrative difficulties and Michigan's interest in the dispute of its resident S2 Yachts.

Terminations

Engine Distributor Spins Its Wheels in Termination Appeal

In a terse, *per curiam* decision, the Eleventh Circuit Court of Appeals upheld a district court's determination that the preferential treatment given by a distributor to another manufacturer's products was grounds for termination of the distributor agreements. *Deutz Corp. v. Engine Distribs., Inc.*, 846 F. App'x 883 (11th Cir. 2021). Deutz is the U.S. affiliate of the German engine manufacturer by the same name. Engine Distributors, Inc. (EDI) distributes various "off highway" models of Deutz diesel engines. Over the course of several years, EDI began to promote Ford gasoline engines as an advantageous "solution" to certain environmental regulatory requirements imposed on the use of diesel engines, even steering potential Deutz purchasers to Ford products. After EDI ignored Deutz's demands that it cease such marketing practices, Deutz brought a lawsuit seeking a declaration its termination of the distribution agreements would be justified. EDI responded with what the district court referred to as "a slew" of counterclaims, some of which were dismissed in the early stages of the litigation. Ultimately, Deutz moved for summary judgment on its declaratory judgment claim and EDI's remaining counterclaims; EDI cross-moved for summary judgment on one of its counterclaims. The district court held that the undisputed facts showed that EDI's marketing practices were harmful to Deutz's goodwill, and thus constituted grounds for termination.

EDI appealed the decision, arguing that the district court had improperly resolved disputed issues of fact in ruling on Deutz's summary judgment motion. The Eleventh Circuit found this approach entirely unconvincing. The panel wrote, "EDI's primary contention on appeal is that the district court misapplied the summary judgment standard by resolving disputed issues of fact. But to the extent that EDI has not failed to properly preserve its arguments, the alleged disputed facts that EDI points to either were not disputed in the district court or, if disputed, are not actually material to the district court's ruling." The panel went on to cite the standard for granting summary judgment from FED. R. CIV. P. 56(a) and the principle articulated by the Supreme Court in *Anderson v. Liberty Lobby* that "[t]he mere existence of *some* alleged factual dispute between the parties will not defeat an otherwise properly supported motion for summary judgment." Hence, the Eleventh Circuit affirmed the district court's grant of summary judgment in favor of Deutz.

New Jersey Federal Court Holds Unlawful Chargebacks Claim Barred by New Jersey Franchise Protection Act

A federal court in New Jersey applied the New Jersey Franchise Protection Act (NJFPA) and entered judgment in favor of a car manufacturer on a franchisee's unlawful chargebacks claim. *Mall Chevrolet, Inc. v. General Motors LLC,* 2021 WL 2581665 (D.N.J. June 23, 2021). Mall Chevrolet is an automobile franchise that performs warranty repairs on GM vehicles, and GM reimburses Mall for warranty services provided pursuant to a dealer agreement between the parties. GM became concerned about Mall's warranty reimbursement claims and audited Mall. GM discovered Mall's practices deviated from GM's procedures and determined a substantial chargeback was required for paid warranty claims that were unsubstantiated. After Mall was unable to provide documentation to support the challenged warranty claims, GM determined that Mall submitted false claims for reimbursement and terminated the dealer agreement. Mall sued GM for unlawful termination, breach of contract, and unlawful chargebacks pursuant to the NJFPA. The court initially granted summary judgment in GM's favor on all counts except Mall's unlawful chargebacks claim. GM then subsequently moved for summary judgment on the unlawful chargebacks claim arguing that because Mall materially breached the provisions of the dealer agreement

by submitting nearly 100 false warranty claims, its unlawful chargeback claim was barred by the NJFPA. The court agreed and entered final judgment in GM's favor on all of Mall's claims.

Preliminary Injunctions

Minnesota Federal Court Grants Distributor's Motion for Preliminary Injunction to Prevent Former Licensee from Continuing to Sell Distributor's Products

A federal court in Minnesota granted a distributor's motion for a preliminary injunction to prevent a former licensee from continuing to use its trademarks after the distributor terminated the parties' license agreement. *Powerlift Door Consultants, Inc. v. Shepard*, 2021 WL 2911177 (D. Minn. July 12, 2021). Powerlift sent Shepard a notice that it was terminating Shepard's distribution agreement after Shepard sent an email to other Powerlift licensees that described Powerlift's products as defective and poor quality and expressed desire to change the model from a distribution to franchise model. Shepard continued to sell Powerlift's products and represent that it was affiliated with Powerlift. Powerlift filed suit against Shepard, alleging breach of contract and various trademark infringement claims and also sought a preliminary injunction to enjoin Shepard's conduct.

The court granted Powerlift's motion for preliminary injunction. It ruled that Powerlift was likely to succeed on the merits for the breach of contract claim because the distribution agreement permitted Powerlift to terminate the agreement if Shepard engaged in any conduct that could harm the goodwill associated with Powerlift's trademarks. The court also held that Powerlift was likely to succeed on the trademark infringement claims and demonstrated a threat of irreparable harm because Powerlift had a federally registered trademark and unauthorized use of the marks by Shepard may create a likelihood of confusion. Finally, the court held the final two elements, balance of harms and public interest, both weighed in Powerlift's favor. The court noted that while an injunction may put Shepard out of business and in default under other contracts and loans, such harms were self-inflicted.

Fraud/Misrepresentation

Wisconsin Federal Court Grants Distributor's Motion to Dismiss Fraudulent Inducement Claims

A federal court in Wisconsin has dismissed a dealer's claim that a supplier fraudulently induced the dealer to enter into a distributor agreement. *Mid-South AG Equipment, Inc. v. Wacker Neuson America Corporation*, 2021 WL 2875610 (E.D. Wis. July 8, 2021). Wacker Neuson America, a seller of construction equipment, entered into a distributor agreement with Mid-South AG Equipment whereby Mid-South purchased equipment from Wacker for resale in Kentucky. Mid-South alleged that, prior to entering into the distributor agreement, Wacker verbally promised to repurchase any equipment Mid-South was unable to sell. After Mid-South found itself unable to sell Wacker's equipment and decided to terminate the agreement, however, it found that Wacker would not repurchase unused and unsold equipment without discounting the purchase price significantly. Mid-South filed suit, claiming Wacker had fraudulently induced Mid-South to enter into the agreement with its repurchase promise.

Wacker filed a motion to dismiss arguing, among other things, that Mid-South could not have reasonably relied on the alleged verbal promise that Wacker would repurchase the equipment — an element required

to establish fraudulent inducement — because the distributor agreement explicitly stated Wacker could repurchase the equipment "at its option." Mid-South argued that it justifiably relied upon Wacker's misrepresentation because it could be seen as a promise by Wacker to affirmatively exercise its discretion under the distributor agreement to repurchase the inventory. The court found that the explicit terms of the distributor agreement allowing Wacker to repurchase of the equipment "at its option" directly contradicted any verbal promise guaranteeing such repurchase. As a result, despite case law holding reliance to be a factual determination for the jury except in rare circumstance, the court held "no reasonable finder of fact could conclude" that Mid-South's reliance was reasonable. The court, therefore, dismissed Mid-South's claim.

State Franchise Laws

Wisconsin Federal Court Concludes Contract to Sell Garmin Watches Was Not a Dealership Under the Wisconsin Fair Dealership Law

A federal court in Wisconsin has recently granted defendant Garmin International's motion to dismiss a claim under Wisconsin's dealer law, which it concluded did not apply to the parties' relationship. *Watch & Accessory Co. v. Garmin Int'l, Inc.*, 2021 WL 2822662 (E.D. Wis. July 7, 2021). In 2015, WatchCo agreed to become a nonexclusive, independent dealer of Garmin watches. Initially WatchCo purchased watches at a 45% discount; Garmin later reduced the discount to 35%. Subsequently, Garmin notified WatchCo that the discount would be reduced to as low as 15% if WatchCo continued to sell watches primarily online. WatchCo filed suit claiming that Garmin violated various provisions of the Wisconsin Fair Dealership Law (WFDL) by improperly attempting to modify the contract without good cause. Garmin filed a motion to dismiss, claiming that its relationship with WatchCo was not a "dealership" subject to regulation under the WFDL. The district court agreed and dismissed the complaint.

To state a claim under the WFDL, WatchCo had to allege the existence of a dealership. A dealership, as defined by the WFDL, must have a "community of interest" between the grantor and the dealer, which in turn requires both a continuing financial interest and interdependence between the parties. The contract between Garmin and WatchCo required little commitment on either side other than buying or selling watches. Further, WatchCo failed to allege any facts suggesting the existence of shared goals and a cooperative effort more significant than the typical vendor-vendee relationship, which is essential under the multi-factor test the Wisconsin Supreme Court previously set out to determine the existence of a community of interest. For these reasons, the court dismissed the complaint without prejudice, but allowed WatchCo 30 days to attempt to replead its claim in an amended complaint.

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