GRAY PLANT MOOTY

# *The GPMemorandum*

**TO:** OUR FRANCHISE 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 of interest to companies that use distributors and dealers rather than managing a business format franchise system. The topics this quarter include termination, antitrust, applicability of state and federal statutes, and more. Here are our summaries of some of the most recent developments of interest to manufacturers and others who supply products through dealers and distributors:

## TERMINATIONS

### DISCONTINUATION OF A BRAND IS GOOD CAUSE FOR TERMINATION OF A DISTRIBUTOR AGREEMENT UNDER THE MAINE FRANCHISE ACT

Last month the Seventh Circuit reversed a $2.1 million jury verdict and held that the defendant's action amounted to discontinuation of a product brand, which is good cause for termination under the Maine Franchise Act. *FMS, Inc. v. Volvo Const. Equip. N. Am., Inc.*, 557 F.3d 758 (7th Cir. Mar. 4, 2009). This was the second trip by this case to the court of appeals.

The plaintiff had been a Samsung construction equipment distributor. One year into the relationship, Samsung had sold its construction equipment division to Volvo and given Volvo three years to phase out the use of the Samsung name and trademark. Volvo began redesigning and rebranding the equipment and, in the process, terminated the majority of Samsung dealers, including the plaintiff. The plaintiff and five other dealers sued Volvo alleging breach of contract and violation of various state franchise statutes.

After the original appeal by the plaintiff, the case was remanded to determine whether Volvo had actually discontinued the product or had simply modified it and kept it in production. The case proceeded to trial, at which a jury determined that Volvo's changes to the equipment were not truly a discontinuation, and therefore Volvo had violated the Maine Franchise Act by terminating without good cause. It awarded the plaintiff $2.1 million in damages.

On the second appeal, Volvo contended that the equipment at issue was Samsung branded equipment and that by changing the brand, Volvo had discontinued the Samsung product. The Seventh Circuit agreed, holding that the Samsung brand constituted the "goods" plaintiff had contracted to distribute. As a consequence, there was a true discontinuation of the product by Volvo and it constituted good cause for termination under the Maine statute.

## MARKET WITHDRAWAL IS NOT "GOOD CAUSE" FOR TERMINATION UNDER THE ARKANSAS FRANCHISE PRACTICES ACT

Conversely, in *Larry Hobbs Farm Equip., Inc. v. CNH America, LLC*, 2009 WL 153357 (Ark. Jan. 22, 2009), the Supreme Court of Arkansas answered much differently questions from a federal court regarding the interpretation of provisions in the Arkansas Franchise Practices Act ("AFPA") and the Arkansas Farm Equipment Retailer Franchise Protection Act ("AFERFPA"). This case arose after CNH America informed Hobbs it would no longer be supplying "DMI" brand equipment to Hobbs because CNH was withdrawing that product from the market. CNH had been selling identical tillage and soil equipment to Hobbs' competitor, Heartland, under a different brand name and different paint color.

The first question to the Arkansas high court was whether market withdrawal—that is, no longer supplying DMI equipment—constituted "good cause" to terminate the dealer agreement with Hobbs under the AFPA. In analyzing the AFPA, the court looked at the plain language of the statute, along with the canon of statutory construction that the express designation of one thing means the exclusion of another. Under that construct, since market withdrawal was not one of the eight specifically enumerated "good cause" circumstances in the AFPA, market withdrawal was not "good cause" to terminate under the statute, the court found.

Other certified questions in this case dealt with liability and remedies under the AFERFPA. On liability, the court found that a provision in the act specifically requiring an "*attempt or threat* to terminate" an agreement did not apply when there was *actual* termination (as was the case between CNH and Hobbs), and therefore did not create liability. As for the remedies issue, Hobbs argued that money damages, although not specifically mentioned in the act, were available beyond the repurchase of inventory and attorneys' fees. The court disagreed. It found that there is no language in the statute authorizing money damages, therefore limiting Hobbs to non-monetary damages such as injunctive and declaratory relief.

## STATE LAWS

### DISTRIBUTOR IS NOT A DEALER UNDER WISCONSIN FAIR DEALERSHIP LAW

In *Kay Beer Distributing, Inc. v. Energy Brands, Inc.*, 2009 WL 425821 (E.D. Wis. Feb. 20, 2009), a beverage distributor sued Energy Brands, Inc., alleging violation of the Wisconsin Fair Dealership Law ("WFDL") and breach of contract. The plaintiff distributor, Kay Beer Distributing, Inc., had been a distributor of Energy Brands' "Glacéau" line of products, which includes Vitaminwater drinks, but these products were a very small part of Kay's business. Kay signed a termination and release agreement ostensibly terminating the distributorship and clearing the way for Energy Brands to establish a larger distributor to cover Kay's former territory. Despite the apparent termination (the intent and effect of which were in dispute), Kay continued to distribute a small amount of product in a smaller area by buying through the larger distributor. In 2007, Coca-Cola purchased Energy Brands and paid a substantial sum to buy out the larger distributor's contract. Kay received no portion of the buy-out and filed a lawsuit against Energy Brands, alleging that the termination violated both the WFDL and an alleged oral contract permitting Kay to distribute in its smaller area.

Energy Brands moved for summary judgment on Kay's WFDL claim. The WFDL expressly applies only to relationships between a "grantor" and a "dealer" where there is a "community of interest" between the grantor and the dealer. Energy Brands asserted that no community of interest existed between it and Kay, because Glacéau represented a very small part of Kay's business. The court noted that the Wisconsin Supreme Court has distilled the complex community of interest determination into two key "guideposts:" (1) the extent to which the dealer and the grantor have a continuing financial interest in their business relationship; and (2) the interdependence of the dealer and grantor—the degree to which they coordinate activities and share common goals. In interpreting WFDL cases, the Seventh Circuit has developed its own test, assessing the percentage of profits the alleged dealer derives from dealing in the grantor's goods and the amount of time and money invested by the dealer in the business. If these two factors result in the grantor having the dealer "over a barrel," such that the dealer is unable to negotiate with the grantor, there is a community of interest. Kay argued that the community of interest question requires a jury trial in all cases. The court disagreed, holding that when all material facts are undisputed, it is the court's role to determine whether a "community of interest" exists. The district court found that because the Glacéau line amounted to less than one percent of Kay's sales and profits, Energy Brands did not have Kay "over a barrel" in the relationship. Therefore, Kay was found not to be a dealer entitled to the protections of the WFDL.

Energy Brands' motion for summary judgment on the WFDL claim was granted, although the case proceeded on Kay's breach of contract claim.

## GIRL SCOUT COUNCILS ARE "DEALERS" UNDER WISCONSIN FAIR DEALERSHIP LAW

In *Girls Scouts Manitou Council, Inc. v. Girls Scouts Of The United States Of America, Inc.*, Bus. Franchise Guide (CCH) ¶ 14,037 (7th Cir. Dec. 15, 2008), the Seventh Circuit held that a local Girl Scout council was entitled to the protections of the Wisconsin Fair Dealership Law as a "dealer" and issued an injunction preventing the Girls Scouts of the United States of America, Inc. from reducing the size of the council's territory. This case arose out of the GSUSA's attempt to consolidate its national network of local councils into fewer, larger organizations. Girls Scouts Manitou Council, Inc., a local council whose territory included part of Wisconsin, refused to accept the reorganization plan. In response, GSUSA restricted the size of the council's territory. The council then filed a motion for a preliminary injunction to prevent this action, arguing that the reduction in its territory violated the WFDL because it was a unilateral "change in competitive circumstances" without "good cause." After its injunction motion was denied by the district court, the council appealed.

In overturning the district court's decision, the Seventh Circuit explained that the WFDL applies to relationships between a grantor and a dealer when there is an agreement, giving the dealer the right to distribute goods or use the trademarks of the grantor and there is a "community of interest" between the parties. Although the primary purpose of Girl Scout councils is to promote scouting, the court recognized that the councils also earn money to support their activities through the sale of the Girl Scouts' famous cookies. Thus, the court found the WFDL applied to the relationship between the GSUSA and the council and that the latter was a "dealer" under its provisions. The court noted, for example, that the council's charter granted it a territory to distribute goods and services and use of GSUSA's trademarks. Moreover, there was a "community of interest" between the GSUSA and the council because the local entity devoted itself to the promotion of girl scouting and had no ability to seek out other "grantors" of girl scouting—because there were none. (*See* discussion of *Kay Beer Distributing, Inc. v. Energy Brands, Inc.*, above, for further discussion of "community of interest" test under WFDL.)

The Seventh Circuit determined that GSUSA likely did not have "good cause" under the WFDL to restrict the council's territory. It noted that GSUSA had not contended that the council had violated its charter. In addition, although the WFDL provided that there was "good cause" for changing a dealer's territory if a grantor had substantial operating losses and its reorganization strategy was designed to improve profitability, such was not the case here. The Seventh Circuit found instead that the GSUSA enjoyed healthy and substantial revenues paid by local councils. Moreover, the Seventh Circuit called into question GSUSA's motives. Although GSUSA had a stated policy to consolidate councils with fewer territories, it had actually reduced the size of the council's territory. Finding that the council would likely succeed on its claims, the Seventh Circuit granted the injunction preventing the reduction in territory pending a ruling on the merits.

## ALABAMA MOTOR VEHICLE FRANCHISE ACT DOES NOT PRECLUDE RETROSPECTIVE RELEASE OF CLAIMS

The Alabama Motor Vehicle Franchise Act provides that "notwithstanding the terms, provisions, or conditions of any dealer agreement or franchise or the terms *or any provisions of any waiver* . . . any person who is injured . . . by a violation of this chapter . . . may bring a civil action . . . " (emphasis added). In response to a certified question, the Alabama Supreme Court has determined that the Act's language did not render unenforceable the settlement and release of existing claims. With that direction, the Court in *Edwards v. Kia Motors America, Inc.*, 2009 WL 24198 (11th Cir. Jan. 6, 2009), found that all of the plaintiff's claims were barred by the release into which he previously entered with the defendant.

## MINIMUM PURCHASE REQUIREMENT AND PRODUCT MARK-UP WERE NOT FRANCHISE FEES UNDER MINNESOTA FRANCHISE ACT

The federal Eighth Circuit Court of Appeals has affirmed the denial of an injunction sought by a distributor under the Minnesota Franchise Act. *Coyne's & Co., Inc. v. Enesco, LLC*, 553 F.3d 1128 (8th Cir. Jan. 23, 2009). The distributor had sought to prevent the termination of its distributorship agreement. Coyne's & Co. had entered into an exclusive North American Distributorship Agreement with Country Artist, Ltd. ("CA") for a product line manufactured in England. Several years later, CA was placed into receivership and its assets were sold to Enesco, LLC. Soon thereafter, Enesco terminated Coyne's distributorship and announced that it would sell CA's products in the United States directly. The federal district court held that the agreement was not subject to the MFA because there was no "franchise fee" paid by the plaintiff.

On appeal, the Eighth Circuit noted Coyne's admission that it did not pay what would normally be considered a direct franchise fee for the right to distribute CA's products. The Eighth Circuit then analyzed whether Coyne paid an indirect franchise fee through either the minimum purchase requirement or a 35 to 50 percent product mark-up. The appeals court acknowledged that an unreasonable minimum purchase requirement could constitute an indirect franchise fee. Because Coyne had failed to assert that CA's minimum purchase requirements were unreasonable, however, the district court's ruling was upheld. With respect to the product mark-up, the Eighth Circuit sustained the finding that the product mark-up was not an indirect franchise fee, but rather

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reflected CA's profits on its products, *i.e.*, a bona fide wholesale price. Because there was no franchise fee paid by Coyne, the Eighth Circuit concluded that the federal court did not err in denying the injunction.

**AUTOMOBILE DEALER LACKED STANDING TO CHALLENGE RELOCATION OF NEW NEIGHBORING DEALER**

In *Raines Imports, Inc. v. American Honda Motor Co., Inc.*, 2009 WL 230644 (W. Va. Jan. 30, 2009), Raines Imports sought relief pursuant to a state statute requiring manufacturers and distributors to give written notice to motor vehicle dealers located within 15 miles of a location at which the manufacturer or distributor intends to establish or relocate a new dealer. Upon receipt of the notice, the affected dealer may bring a declaratory judgment action to determine whether good cause exists for establishing or relocating the proposed new motor vehicle dealer.

The West Virginia Supreme Court of Appeals found that Raines lacked standing to bring its action. Notice is only required if the new or relocated dealer will be within the pre-existing dealer's relevant market area. The letter from American Honda that had provoked this case did not implicate the notice and challenge provisions because the letter stated only that American Honda was *considering* locating a new dealer in the area and did not specify a location within the dealer's "relevant market area," as defined in the statute.

## OPERATION OF MULTIPLE SYSTEMS

**LICENSOR DID NOT BREACH AGREEMENT BY COMPETING IN FRANCHISEES' TERRITORY WITH ANOTHER BRAND**

A federal court in Texas has granted summary judgment in favor of Budget Rent-A-Car Corp., finding that Budget did not breach its license agreements with the plaintiff franchisees when Budget's sister company, Avis Rent A Car Systems, LLC, began operating Avis rental car locations in the franchisees' exclusive territory. *Sirrah Co., Inc. v. Budget Rent-A-Car Corp.*, 2009 WL 563654 (W.D. Tex. March 4, 2009). Budget became a subsidiary of Avis Budget Car Rental, LLC in an acquisition by Avis. That company is also the parent company of Avis.

The franchisees in this case executed two license agreements with Budget that granted them the exclusive right to be the only Budget licensees in their designated territories. The agreements pre-dated the acquisition of Budget by Avis. In suing, the franchisees alleged that they had an exclusive license to operate a rental car business in their designated territories and that the operation of the Avis rental car locations breached the exclusivity provisions of their license agreements with Budget. On Budget's motion for summary judgment, the court rejected the franchisees' argument, finding that the intent of the license agreements was not to make the franchisees the only rental car business in their territories but to make them the only licensees in their territories that could operate a rental car business using the Budget trademark and business system.

## ANTITRUST

### FOURTH CIRCUIT REJECTS DISTRIBUTOR'S ATTEMPTED USE OF *LEEGIN* DECISION

The Supreme Court's landmark 2007 antitrust decision applying rule of reason analysis to resale price maintenance claims brought under federal law was most recently addressed by the Fourth Circuit Court of Appeals in *Valuepest v. Bayer*, 2009 WL 756901 ($4^{th}$ Cir. March 24, 2009). The defendant suppliers in this case sold through what they called "agency" relationships, as distributors merely facilitated sales to the ultimate purchasers. The resale price maintenance claim arose out of the contractual rights of the manufacturer defendants to set the price at which the product was sold to the end-users. Valuepest, which was one of the end-users, filed a class action lawsuit alleging vertical price fixing between the manufacturers and their distributors. Two weeks after the *Leegin* decision was issued, a North Carolina federal district court granted the defendants' motions for summary judgment. The district court held that the contracts with distributors represented genuine agency relationships that did not support liability under Section 1 of the Sherman Act because, when a distributor is simply an agent of the manufacturer, then there can be no illegal "agreement" between two parties.

On appeal to the Fourth Circuit, the plaintiffs argued that *Leegin* implicitly overruled the "agency defense" established eight decades ago in *United States v. General Electric Co.* In *General Electric*, the Supreme Court had held that a manufacturer may lawfully set minimum prices for its products when there is a genuine principal-agent relationship between the manufacturer and its distributors. In upholding summary judgment for the defendants, the Fourth Circuit held that "*Leegin* did not eliminate the agency defense to a claim of resale price maintenance . . .".

Under this ruling, manufacturers protected by the agency defense should not be subject even to rule of reason analysis because the lack of an agreement between two parties would render immaterial any question whether trade is restrained unreasonably.

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