GRAY PLANT MOOTY

The GPMemorandum

TO: OUR FRANCHISE AND DISTRIBUTION 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 primarily of interest to companies that use distributors and dealers rather than manage a business format franchise system. The distribution-related topics this quarter include terminations, application of state statutes, contract issues, and more.

POST-TERMINATION INJUNCTIONS

SEVENTH CIRCUIT AFFIRMS DENIAL OF PRELIMINARY INJUNCTION FINDING PMPA TERMINATION FOR FAILURE TO PAY WAS PROPER

After remanding to the federal district court for the Northern District of Illinois, the United States Court of Appeals for the Seventh Circuit affirmed the district court's denial of a preliminary injunction motion under the Petroleum Marketing Practices Act ("PMPA"), finding that the franchisee's multiple insufficient funds transactions constituted "failures" under the PMPA, thus justifying termination of the relationship. *Joseph v. Sasafrasnet, LLC*, 2013 U.S. App. LEXIS 22395 (7th Cir. Nov. 4, 2013). In November 2010, Sasafrasnet, an authorized British Petroleum distributor, terminated Joseph's service station franchise after three failed attempts to debit Joseph's account for payment of fuel deliveries. Joseph filed for preliminary injunctive relief to enjoin Sasafrasnet's termination, and in May 2011, the district court denied Joseph's motion reasoning that Joseph failed to present any serious question going to the merits of the termination.

On appeal, the Seventh Circuit remanded the case back to the district court for a determination of whether Joseph's NSF transactions constituted "failures" under the PMPA. In its remand order, the Seventh Circuit noted that while the PMPA authorizes termination if an event occurs that is relevant to the franchise relationship, Joseph's NSFs might not constitute "failures" under the PMPA if they were technical or unimportant to the franchise relationship, or if they were outside Joseph's control. On remand, the district court concluded that two of Joseph's NSFs constituted "failures" under the PMPA, as they resulted from Joseph's decision to change banks and his failure to ensure a smooth transition between his accounts. Finding that the NSFs were entirely within Joseph's control, and given Joseph's history of making late payments, the district court concluded that these failures were not merely technical or unimportant to the parties' relationship. Finding no error in the district court's remanded decision, the Seventh Circuit affirmed.

STATE FRANCHISE AND DEALER LAWS

NEW YORK FEDERAL COURT FINDS LOCAL ADVERTISING REQUIREMENT DOES NOT CONSTITUTE FRANCHISE FEE

In *Nature's Plus Nordic A/S v. Natural Organics, Inc.*, 2013 U.S. Dist. LEXIS 159157 (E.D.N.Y. Nov. 6, 2013), the United States District Court for the Eastern District of New York found that the local advertising requirement in a distributorship agreement did not constitute a "franchise fee" under the New York Franchise Sales Act ("NYSA"). In the case, Natural Organics, Inc. terminated a distributorship agreement when the distributor, Nature's Plus, failed to meet the agreement's minimum local advertising requirement and minimum gross sales requirement. Nature's Plus sued, claiming wrongful termination and alleging violations of the NYSA. The only payments required under the distributorship agreement were payments due to Natural Organics for products sold at wholesale prices. The minimum advertising requirement was not payable to Natural Organics. Nature's Plus argued that the minimum advertising requirement constituted a franchise fee, triggering the applicability of the NYSA.

The court found that a local advertising requirement may constitute a franchise fee under section §681(3) of the NYSA if the fee is paid "for the right to enter into the business," even if the local advertising requirement is not payable to the alleged franchisor. In this case, however, because the distributorship agreement expressly stated that the advertising requirement was made as partial consideration for certain product discounts, the advertising payments were not made for the right to enter into a business and did not constitute "franchise fees" under the NYSA. With respect to the distributor's wrongful termination claims, the court found that Natural Organics wrongfully terminated the distributorship agreement because, as a matter of law, Nature's Plus substantially complied with the minimum gross sales requirement by achieving 99.5% of the gross sales required under the contract. The court did determine that genuine issues of material fact remained as to whether Nature's Plus met its minimum advertising requirement.

ILLINOIS DISTRICT COURT GRANTS IN PART AND DENIES IN PART SUPPLIER'S MOTION TO DISMISS FOR FAILURE TO STATE A CLAIM

A federal court in Illinois has granted in part and denied in part a manufacturer's motion to dismiss claims brought under the Illinois Franchise Disclosure Act of 1987 ("IFDA") and the California Franchise Relations Act ("CFRA") arising from the termination of a distribution agreement. *H.C. Duke & Son, LLC v. Prism Mktg. Grp.*, 2013 U.S. Dist. LEXIS 140254 (C.D. Ill., Sept. 30, 2013). H.C. Duke & Son and Prism Marketing Group were parties to an agreement in which Prism distributed Duke's line of soft-serve ice cream machinery and related equipment. Duke terminated the agreement and Prism contested. Duke therefore sought a declaratory judgment and additional relief, and Prism filed a counterclaim, including allegations that Duke's termination violated the IFDA and CFRA. Duke moved to dismiss for failure to state a claim, challenging Prism's eligibility for protection under the IFDA and CFRA on the basis that no franchise fee was paid. Duke further argued that Prism fell outside the IFDA's protected class.

To qualify as a franchise under the IFDA and CFRA, both acts require the franchisee to pay the franchisor a franchise fee exceeding $500 and $100, respectively. A franchise fee may exist regardless of the designation or form of the fee. Prism alleged that it was required to assume the debt of a prior distributor, and made payments to Duke to purchase and carry certain parts, and for advertising and promotional materials. The court held that such allegations constituted a plausible claim that a franchise fee was paid, and they were sufficient to meet the notice pleading requirement. Therefore, Duke's motion to dismiss Prism's claims under the CFRA was denied. However, the court agreed with Duke's allegation that Prism fell outside the protected class of the IFDA, as the IFDA's purpose is to protect Illinois residents. Prism is a Nevada corporation with a principal place of business in Washington. Additionally, the parties' agreement only permitted Prism to distribute Duke products in Nevada and California. Although Prism argued that the agreement was executed in Illinois and required Duke's action in Illinois, the court held that these allegations did not create a reasonable inference that Prism was located in Illinois. Therefore, the court granted Duke's motion to dismiss Prism's claims under the IFDA.

REPURCHASE OF INVENTORY CLAIM SURVIVES SUMMARY JUDGMENT UNDER VIRGINIA EQUIPMENT DEALERS PROTECTION ACT

In *James River Cos. v. BB Buggies, Inc.*, No. 4:13-cv-00004 (W.D. Va. Sep. 6, 2013), the United States District Court for the Western District of Virginia denied summary judgment for BB Buggies on a dealer's claim for failure to repurchase inventory pursuant to the Virginia Equipment Dealers Protection Act ("VEDPA"), but granted summary judgment to BB Buggies' parent company. The parties' relationship began in

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2006 when James River entered into an oral dealer agreement with Bad Boy Enterprises, LLC and purchased several buggies. In October 2010, Bad Boy sold its assets to BB Buggies, but James River and BB Buggies did little business thereafter. When BB Buggies refused the dealer's demand to repurchase pursuant to the VEDPA, James River sued. BB Buggies moved for summary judgment, arguing that the inventory was expressly exempt from the statutory requirements because (1) the unsold products were not "current models", (2) the inventory was purchased more than 36 months prior to notice of termination of the agreement, (3) James River did not have clear title, and (4) the equipment was "not in new, unused, undamaged, and complete condition."

The court found that the applicability of the first two statutory exceptions hinged on when the parties' dealer relationship ended. If it ended by "non-continuance" in 2010 when Bad Boy sold its assets, then neither exception applied because the buggies were purchased within three years prior to that date and, though some were no longer being manufactured, they still may have been "current," as defined in the statute, if they were still listed in BB Buggies' then-current sales manual. If, however, the relationship was not terminated until James River sent a termination letter in November 2011, then summary judgment would be appropriate. Because there were material fact disputes on each issue, the court declined to grant summary judgment. Conflicting evidence regarding encumbrances on the inventory and the condition of the buggies also precluded summary judgment based on the other two statutory exceptions they raised.

BB's parent, Textron, did succeed in getting itself dismissed on summary judgment. The court found that Textron did not have an agreement with James River, so the VEDPA could not apply.

COMMUNITY OF INTEREST FACT QUESTIONS UNDER WISCONSIN FAIR DEALERSHIP LAW PREVENT SUMMARY JUDGMENT

A federal court in Wisconsin recently denied a dealer's motion for summary judgment under the Wisconsin Fair Dealership Law ("WFDL"), due to a genuine fact dispute regarding the existence of a community of interest between the parties. In *Wholesale Partners, LLC v. Masterbrand Cabinets, Inc.,* Bus. Franchise Guide ¶ 15,136 (CCH) (E.D. Wis. Oct. 4, 2013), a newly formed cabinetry retailer orally agreed to take over the dealership of an insolvent former dealer of manufacturer Masterbrand. At the same time, Wholesale Partners also agreed to take on the former dealer's debt to Masterbrand. Wholesale Partners then began buying inventory from Masterbrand and making payments on the former dealer's debt. A few months later, Masterbrand informed Wholesale Partners that it was immediately terminating it as a dealer. At the time of termination, sales of Masterbrand cabinetry constituted 43% of Wholesale Partners' gross revenues. No written notice or opportunity to cure was given, and Masterbrand did not articulate "good cause" for termination, as required under the WFDL.

In the suit that followed, Wholesale Partners moved for summary judgment on Masterbrand's liability for violating the WFDL. For the WFDL to apply, there must be a "community of interest" in the relationship between a grantor and a dealer, which requires either (1) a significant portion of the dealer's revenues to be derived from the sale of the grantor's products, or (2) the dealer to have made a sizable investment relating to the sale of the grantors goods, or (3) some combination of the two. Although the parties had no written dealership agreement, Masterbrand admitted in its court documents that it had treated Wholesale Partners as a dealer on a "temporary basis." The court found that Masterbrand's statement was "equivocal, at best" and therefore did not constitute a judicial admission by Masterbrand that a dealership relationship existed for purposes of the WFDL. The court went on to note that the significant investment by Wholesale Partners in the Masterbrand line of products, its assumption of the former dealer's debt, and the fact that Masterbrand accounted for 43% of Wholesale Partners' revenues weighed in favor of a finding that a community of interest existed, while the short duration of the relationship weighed against such a finding. As a result, the court found that a genuine fact issue existed as to community of interest, and denied summary judgment.

OHIO SUPREME COURT ALLOWS SUCCESSOR MANUFACTURER TO TERMINATE DISTRIBUTORSHIP UNDER THE OHIO ALCOHOLIC BEVERAGES FRANCHISE ACT

The Ohio Supreme Court recently affirmed an appellate court's decision finding that the Ohio Alcoholic Beverages Franchise Act clearly permits a successor manufacturer to appoint its own distributors, provided that the successor manufacturer gives the existing distributor notice and compensation. *Esber Beverage Co. v. Labatt USA Operating,* Slip Op. 2013-Ohio-4544 (Ohio Oct. 17, 2013). Esber Beverage Company had been a distributor of Labatt brands for many years. The Labatt brands were acquired by Labatt USA Operating in March 2009 and Labatt notified Esber that it intended to terminate Esber's distributorship and compensate Esber under the Act. Esber reacted by filing a complaint seeking to stop the termination. The trial court entered a preliminary injunction preventing the termination after finding that the termination rule of the Act applies to a successor manufacturer only when there is no written distribution agreement in place. Esber's written distribution agreement had been assigned to Labatt. The appellate court reversed the decision and the Ohio Supreme Court agreed, finding that under the Act, when a manufacturer assigns its rights respecting a certain alcoholic beverage to a successor manufacturer, the successor may "terminate any distributor's franchise without just cause by giving the distributor notice of termination within 90 days of the acquisition" and compensation, even if there is a written distribution agreement in place.

CONTRACTS

COURT GRANTS PARTIAL JUDGMENT TO DISTRIBUTOR ON COMMISSION CLAIM

The United States District Court for the Eastern District of Wisconsin has determined that a manufacturer was contractually required to pay a commission to one of its distributors in connection with the sale of its industrial hoist equipment. *Marine Travelift, Inc. v. Marine Lift Sys., Inc.*, 2013 U.S. Dist. LEXIS 144435 (E.D. Wis. Sept. 30, 2013). The parties had entered into a distributorship agreement that granted the distributor, Marine Lift Systems, a nonexclusive right to purchase equipment from the manufacturer, Marine Travelift, and then resell it to customers at marked-up prices. The agreement specified that the distributor was not entitled to any wages or commissions from Marine Travelift and was to look only to its customers for payment. The parties subsequently entered into a separate written agreement (the unit order coversheet, or the "UOC") to arrange for the sale of a boat hoist to a particular purchaser. The UOC contemplated that Marine Travelift would sell the hoist to the purchaser directly and then pay the distributor a commission equal to its usual markup. When Marine Travelift later terminated the distributorship agreement and brought suit against the distributor, the distributor counterclaimed for breach of the UOC on the grounds that it never received any payment for the boat hoist sale and sought exemplary damages and attorneys' fees under Wisconsin's independent sales representative statute.

The court held that Marine Travelift was liable for the commission it agreed to pay on the boat hoist sale and granted summary judgment to the distributor on its counterclaim. While Marine Travelift argued that the distributor was not entitled to a commission based on the plain terms of the agreement, the court concluded that the UOC represented a separate, binding agreement according to which Marine Travelift indisputably obligated itself to pay a commission for the particular sale at issue. The court also rejected Marine Travelift's argument that there was a material dispute as to whether the distributor fulfilled its obligations under the UOC. The facts of record established that the commission was conditioned only on Marine Travelift receiving full payment from the buyer, which had already occurred. Marine Travelift further argued that summary judgment was premature because it was entitled to offset any amounts it owed to the distributor by losses it sustained as a result of the distributor's breaches of the distributorship agreement. The court held that the mere possibility that Marine Travelift would prevail on one of its claims against the distributor did not create a triable issue as to Marine Travelift's liability on the counterclaim.

Finally, although the court held that the distributor was entitled to a commission under the UOC, the court determined that the distributor could not obtain exemplary damages or attorneys' fees under Wisconsin's independent sales representative statute because it did not qualify as an independent sales representative.

PENNSYLVANIA DISTRICT COURT DISMISSES BEER DISTRIBUTOR'S AMENDED COMPLAINT AGAINST MILLERCOORS

The United States District Court for the Western District of Pennsylvania dismissed with prejudice a beer distributor's amended complaint alleging violations of a distributorship agreement between the parties. *Frank B. Fuhrer Wholesale Co. v. MillerCoors LLC*, 2013 U.S. Dist. LEXIS 155253 (W.D. Pa. Oct. 30, 2013). Under the agreement, Frank B. Fuhrer Wholesale Co. was granted exclusive distribution rights for certain Coors products in a nine-county area including metropolitan Pittsburgh. The agreement allowed MillerCoors to add products to the list of those for which the distributor had exclusive distribution rights, and gave Fuhrer Wholesale the right to sell other beer manufacturers' products. MillerCoors later conditioned Fuhrer Wholesale's distribution of new craft or specialty beers on its creation of a new entity dedicated exclusively to MillerCoors products. Fuhrer Wholesale sued, alleging that MillerCoors had breached the distributorship agreement, violated the Pennsylvania Liquor Code, and engaged in an "unreasonable restraint of trade."

The distributor supported its breach of contract claim by arguing that the restrictions contained in the Pennsylvania Liquor Code were implied terms of its contract. In dismissing that claim, the court held that because the statute does not create a private right of action, an alleged violation could not support Fuhrer Wholesale's breach of contract claim. Further, the court held that the distributorship agreement permitted, but did not require, MillerCoors to grant Fuhrer Wholesale rights to new beer brands. In dismissing the distributor's allegation of an "unreasonable restraint of trade," the court noted that the distributor had stated that it was not seeking to allege a common law antitrust claim and held that there was no other private right of action for an "unreasonable restraint of trade" in the context presented by the case.

COURT DISMISSES COMPLAINT FINDING NO EXCLUSIVE ARRANGEMENT IN THE PARTIES' DISTRIBUTION AGREEMENTS

A Pennsylvania federal court has granted a manufacturer's motion to dismiss a complaint for breach of distribution agreement. In *Assalone v. S-L Distribution Co., Inc.*, 2013 U.S. Dist. LEXIS 149625 (M.D. Pa. Oct. 17, 2013), Assalone sued S-L, the manufacturer of Snyder's snack foods, claiming that it breached the exclusivity provisions of the parties' distributorship agreements by distributing another line of snack foods in Assalone's territories. In 1999, Assalone entered into separate agreements with a food manufacturer and distributor of Snyder's products. The majority of the agreements provided Assalone with the exclusive right to sell and distribute "authorized products" in the New York metropolitan area. Authorized products were defined in the agreements as those items sold under the Snyder's trademark and identified on an attached price list. In 2010, S-L acquired the assets of

Snyder's and assumed the distribution agreements. S-L is a wholly-owned subsidiary of a larger parent corporation that also had the right to sell other snack foods called the Lance products. Problems emerged when S-L notified Assalone that it could not sell the Lance products and excluded those products from Assalone's price list. Assalone claimed that S-L's action breached the parties' exclusive arrangement.

The court sided with S-L, finding that the agreements only allowed Assalone to sell Snyder's items that were specifically identified on the price list. The specific price list attached to Assalone's complaint expressly excluded the Lance products, and Assalone's exclusivity was limited to the "authorized products" listed on the price list. Furthermore, the products being sold by other distributors in the plaintiff's territories were not Snyder's, but the Lance products. The court found these facts dispositive and dismissed Assalone's complaint.

TERMINATIONS

COURT DENIES SUMMARY JUDGMENT ON STATUTORY AND EQUITABLE CLAIMS IN MISSOURI DEALER TERMINATION SUIT

In *Machine Maintenance, Inc. v. Generac Power Systems, Inc.*, 2013 U.S. Dist. LEXIS 14275 (E.D. Mo. Oct. 8 2013), a federal court in Missouri denied cross motions for summary judgment in a dealer termination dispute. The plaintiff, which did business as Luby Equipment, Inc., was a former nonexclusive seller and servicer of generators manufactured by Generac Power Systems. Generac terminated Luby's Buy/Sell Agreement and Service Agreement at an in-person meeting in December 2011. Although the termination letter that followed the meeting did not specify the reason for termination, Generac claimed it terminated Luby for its failure to meet criteria set forth in a strategic plan entered into by the parties. Luby argued that its termination resulted from Generac's secret discussions with a replacement dealer, and that the termination violated the Missouri Industrial Maintenance and Construction Power Equipment Act, which requires that a supplier give at least ninety days prior written notice of termination, specify all reasons constituting good cause for termination, and provide the dealer with sixty days to cure any deficiency. Luby also sought equitable relief under the recoupment doctrine.

Both parties moved for summary judgment on the statutory claim. Although the court concluded as a matter of law that the generators constituted "power equipment," and thus came within the scope of the statute, it found that factual disputes remained regarding the reasons Generac terminated Luby, whether its reasons constituted good cause, and whether the notice and cure requirements had been satisfied. The court also denied Generac's summary judgment motion on the recoupment claim. Under Missouri law, when an at-will dealer contract says nothing about duration or does not specifically deal with remedies for termination, courts can impute into the contract a duration equal to the length of time reasonably necessary for a dealer to recoup its investment, plus a reasonable notice period before termination. Generac's contract with Luby specified remedies for termination of the Buy/Sell Agreement, but not the Service Agreement. Because the parties had not addressed how the differences between both parts of the Agreement impacted the doctrine, and because neither party addressed how the nonexclusive nature of the contract impacted the doctrine, the court concluded questions of material fact about the doctrine's application remained and denied summary judgment.

WEST VIRGINIA SUPREME COURT AFFIRMS TERMINATION OF DISTRIBUTORSHIP

The Supreme Court of Appeals of West Virginia recently affirmed the termination of an alcohol distribution agreement based on the distributor's repeated failure to timely pay for goods delivered by the supplier. *N. Cent. Distribs., Inc. v. Moats*, 2013 W. Va. LEXIS 1236 (W. Va. Nov. 8, 2013). Attempts by the supplier, Labatt, to withdraw payment from the distributor, NCDI, through electronic funds transfer failed for four consecutive months due to insufficient funds in the distributor's account. Accordingly, Labatt notified NCDI that it had breached the parties' distribution agreement and demanded cure by payment of the owed amounts. Upon NCDI's failure to meet the notice's payment deadline, Labatt terminated the agreement. NCDI ultimately remitted its outstanding balance six months after the payments were due. An administrative body reviewing the termination concluded that Labatt had complied with relevant law governing the termination of alcohol distribution agreements, which prohibited the termination of any such agreement "without due regard for the equities" and without "just cause." NCDI appealed a trial court's affirmance of the administrative ruling.

In its substantive challenge to the termination, NCDI argued that the termination was inequitable and without "just cause" because, under the parties' established business practice, Labatt should have notified NCDI before withdrawing funds from its account and should have credited NCDI for certain damaged goods. NCDI also argued that, under the parties' established business practice, it was permitted to withhold payment during an invoice dispute. In affirming the trial court, the appellate court balked at NCDI's reliance on established business practice to withhold payment. The court noted that Labatt had a strong business interest in the timely collection of amounts it was owed. Further, the court affirmed the finding of "just cause" for the termination, because the distribution agreement expressly provided that timely payment was essential and that failure to timely pay provided "just cause" for termination. Finally, the court affirmed the trial court and administrative body's upholding of the termination, notwithstanding the fact that Labatt's termination notice referenced an outdated version of the parties' agreement.

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