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 termination, antitrust, arbitration, application of state statutes, and more.

ARBITRATION

SIXTH CIRCUIT REJECTS ARBITRATION THAT IT FINDS "WAS A MODEL OF HOW NOT TO CONDUCT ONE"

A previously vacated award of $1.4 million to a former Thomas Kinkade artwork dealer was not revived on appeal this month due to the same irregularities in the arbitration process that had caused a federal district court to reject the award in 2010. *Thomas Kinkade Co. v. White*, 2013 U.S. App. LEXIS 6537 (6th Cir. Apr. 2, 2013). As reported in Issue 129 of *The GPMemorandum*, the district court had found that a dealer and his appointed arbitrator's business dealings with the supposedly "neutral" third arbitrator caused bias that ruined the arbitration. "Evident partiality or corruption in the arbitrators" is a seldom-used ground to vacate an award under the Federal Arbitration Act.

In this case, the third arbitrator's connections to the dealer's side arose and became evident during the nearly 50 hearing days spread over almost five years. This bias manifested itself in unwarranted leniency and favoritism toward the dealer, the court of appeals held. Central to the appellate ruling was that the "neutral" arbitrator had the motive to be biased after his law firm was retained by both the claimant and the claimant's own appointed arbitrator. The third arbitrator's actions and rulings added to the court's concern, undermining the entire process.

DUTY OF GOOD FAITH AND FAIR DEALING

TEXAS FEDERAL COURT REFUSES TO REQUIRE DISTRIBUTOR TO PREVENT ENCROACHMENT BY DEALERS AGAINST EACH OTHER

In *Mailing and Shipping Systems, Inc. v. Neopost USA, Inc.,* 2013 U.S. Dist. LEXIS 44909 (W.D. Tex. Mar. 28, 2013), the United States District Court for the Western District of Texas refused to require a distributor to protect a dealer from territorial encroachment by rival dealers based solely on the duty of good faith and fair dealing set forth in Section 1.034 of the Texas Business and Commerce Code. The plaintiff, a postage meter and mailing machine dealership with territories in Texas and New Mexico, alleged that Neopost, a distributor, breached its dealership agreement and the duty of good faith and fair dealing by failing to prevent territorial encroachment by rival dealers. The parties' agreement prohibited the *dealer* from soliciting, or selling or leasing products to, customers outside of its exclusive territory, but it did not require the distributor to prevent territorial encroachment.

The court held that this provision did not create any contractual obligations on the part of supplier Neopost. It noted that the duty of good faith and fair dealing imposed by Section 1.034 does not apply to all franchise relationships, but may apply to distributorship agreements predominantly involving the sale of goods. The court found that even if Section 1.304 applied to the dealership agreement, the intent of the statutory provision was to buttress the parties' existing promises, and not to create any new obligations for either party. Because the dealership agreement did not expressly state that Neopost would protect the plaintiff from territorial encroachment by rival dealers, the court decided that the duty of good faith and fair dealing did not support the claim for damages.

CHOICE OF LAW

COURT FINDS MINNESOTA SALES REPRESENTATIVE ACT NOT APPLICABLE DESPITE THE PARTIES' CHOICE OF MINNESOTA LAW

The United States District Court for the District of Minnesota recently held that the selection of Minnesota law in a sales representative agreement did not have the effect of incorporating the Minnesota Termination of Sales Representative Act (MTSRA), where the facts of the case did not otherwise result in its application. *North Coast Tech. Sales, Inc. v. Pentair Tech. Prods., Inc.,* 2013 U.S. Dist. LEXIS 28368 (D. Minn. Mar. 13, 2013). Gray Plant Mooty represented the defendant manufacturer in this case. The dispute arose when Pentair sent a notice advising the sales representative that it was reducing the representative's responsibilities, and later that it was terminating the agreement. The sales representative sued, alleging that Pentair's actions violated the MTSRA's requirement that a manufacturer provide ninety days' notice of a breach and a sixty-day cure period prior to terminating a sales representative agreement. In response, Pentair moved to dismiss the MTSRA claim on the ground that the sales representative was located outside of Minnesota and did not sell products in Minnesota, thus was not protected. The sales representative in turn pointed to a choice-of-law provision in its agreement with Pentair, which stated that the contract "will be deemed to have been made in and will be construed in accordance with and governed by the laws of the State of Minnesota," and argued that it was entitled to the MTSRA's protections.

The Minnesota federal court found that the choice-of-law clause merely specified the substantive law under which the contract was to be construed. The clause did not invoke the substantive protections of the MTSRA where the statute itself did not apply to the relationship between the parties. By its terms, the MTSRA protects only representatives who at some point are residents of, or maintain their principal place of business in, Minnesota, or whose geographical territory includes part or all of the state. This sales representative did not fall within the definition. In the court's words, "the choice-of-law clause *applies* Minnesota law; it does not *change* Minnesota law."

This ruling could have broad implications for the construction of not just MTSRA, but of franchise agreements and other contracts that select a protective state law which inherently restricts the class of parties it protects.

FRANCHISE TRANSACTIONS

FEDERAL COURT HOLDS MANUFACTURER DID NOT TIMELY EXERCISE RIGHT OF FIRST REFUSAL

A federal district court in Maryland recently determined that a manufacturer did not timely exercise its right of first refusal to purchase a truck dealership from one of its dealers. *Paccar Inc. d/b/a Peterbilt Motors Co. v. Elliot Wilson Capitol Trucks LLC*, 2013 U.S. Dist. LEXIS 21004, (D. Md. Feb. 8, 2013). In granting the dealer's cross motion for summary judgment, the court focused on the requirement that the dealer give notice in order to trigger the thirty-day option period set forth in the dealership agreement. Dealer Elliot Wilson claimed that the option had expired because Peterbilt untimely exercised it three months after receiving actual notice of the proposed sale. Peterbilt claimed that the notice it received from Elliot Wilson lacked sufficient detail to allow it to act on its right of first refusal because it did not adequately describe the material terms of the sale.

After examining the information provided by Elliot Wilson, the court determined that notice sufficiently informed the manufacturer of the terms of the sale. Although the dealer did not give Peterbilt the actual proposed purchase agreement, it clearly communicated the purchase price and other terms of the deal. Thus, according to controlling case law, the notice triggered Peterbilt's duty to clarify, within a reasonable time period, any questions it had about the sale. Since Peterbilt was aware of the transaction's essential terms and had sufficient time to obtain any other details it needed, the court determined that actual notice had been given and the option period had begun to run. The court therefore held that Peterbilt's exercise of its right of first refusal after the thirty-day deadline was ineffective.

ANTITRUST

TWO MANUFACTURERS' GRANTS OF EXCLUSIVE DEALERSHIPS TO HOME DEPOT HELD NOT ENOUGH TO ALLEGE ILLEGAL AGREEMENT

A federal district court in California this month dismissed claims by a smaller hardware store chain against Home Depot and two manufacturers of power tools. *Orchard Supply Hardware LLC v. Home Depot USA, Inc., et al.*, Case No. 12-cv-06361-JST (N.D. Cal. April 12, 2013). The claim, which was dismissed without prejudice, was that Home Depot had demanded exclusive supply contracts with the two manufacturers, both of which then stopped supplying the plaintiff. Those allegations alone were not enough to state a viable antitrust action, the court held.

The decision rejected each of the plaintiff's theories. First, it would not be inherently illegal for a large dealer like Home Depot to seek and obtain an exclusive distribution agreement with a supplier, the court found. Nor would two suppliers simultaneously reaching exclusive arrangements with the same large dealer constitute an unlawful agreement under Section 1 of the Sherman Antitrust Act. Absent allegations that the two suppliers agreed *with each other* to take parallel action, there can be no horizontal conspiracy, the court held. Lastly, the plaintiff's failure to plead that competition was harmed in a relevant geographic market defeated any theory under the "rule of reason" for weighing antitrust claims. On similar grounds, the court also dismissed claims under California's state antitrust statute and other law. While the plaintiff was given leave to attempt to replead its claims, the firm rejection of its legal theories leaves Home Depot and the manufacturers the victors in this round at least.

GRAY PLANT MOOTY

NEBRASKA SUPREME COURT PROVIDES ITS FIRST INTERPRETATION OF STATE ANTITRUST ACT PROVISION IN CREDIT REPORT RESELLER DISPUTE

Late last month, the Supreme Court of Nebraska affirmed a jury verdict in favor of credit reporting agency Experian Information Solutions, in a lawsuit brought against it by mortgage credit report reseller, Credit Bureau Services, alleging violations of Nebraska's unusual antitrust act. *Credit Bureau Servs., Inc. v. Experian Info. Solutions, Inc.*, 2013 Neb. LEXIS 47 (Neb. Mar. 22, 2013). Evidence was adduced at trial that as part of its "Project Green," Experian increased, over the course of several years, the minimum monthly purchase requirement for mortgage-related information. Plaintiff CBS contended that Experian implemented Project Green to drive out of business a number of resellers, including CBS, and that Experian's conduct violated Section 59-805 of Nebraska's Antitrust Act, which makes it unlawful "to do any act for the purpose of driving out of business any other person engaged therein."

On appeal, CBS challenged the district court's instructions to the jury regarding the elements required to find in favor of CBS on its claim under Section 59-805. The Nebraska Supreme Court, noting that it had not previously enumerated the elements of a cause of action based on the allegation that a defendant acted with purpose of driving the plaintiff out of business under § 59-805, disagreed with CBS' interpretation that the act prohibits all conduct of a defendant that has the effect of driving an entity out of business. The court held that the statute "reaches intentional predatory conduct which has no purpose other than to drive another entity out of business" and the phrase "any act for the purpose of driving out of business" requires that the offending act be purposive.

STATE LAWS

COURT DENIES MANUFACTURER'S MOTION TO DISMISS NEW JERSEY FRANCHISE PRACTICES ACT CLAIM

In *Strassle v. Bimbo Foods Bakeries Distribution, Inc.*, 2013 U.S. Dist. LEXIS 34560 (D.N.J. Mar. 13, 2013), a federal court in New Jersey declined to dismiss a claim under the New Jersey Franchise Practices Act (NJFPA) brought by a group of distributors against Bimbo, a manufacturer of bakery goods. The distributors filed a class action complaint alleging that Bimbo breached their contracts and violated the NJFPA by refusing to allow them to buy and resell various types of bread products in their designated territories.

Bimbo moved to dismiss the NJFPA claim and the distributors' claim for treble damages and lost profits. It argued that the NJFPA did not apply to the distributors because they did not allege that they maintained a place of business in New Jersey, or that the agreements compelled them to maintain such a business, as required under the NJFPA.

In partially denying the motion to dismiss, the court held that the distributors did allege sufficient facts to state a claim under the NJFPA. Specifically, the court observed that the distributors pled in clear terms that they maintained fixed places of business in the state, which allegations the court was obligated to take as true in deciding a motion to dismiss. In addition, the distributors' complaint alleged that the performance of the contracts contemplated that fixed locations would be established, as the contracts anticipated situations in which the distributors could provide bread products without making deliveries. The court did grant Bimbo's request to strike the distributors' demand for treble damages and lost profits, as such relief was barred by the limitation of liability provision in the distributors' contracts.

MINNESOTA COURT OF APPEALS AFFIRMS DISMISSAL OF DEALERSHIP'S UNFAIR PRACTICES AND PRICING DISCRIMINATION CLAIMS

The Minnesota Court of Appeals recently affirmed rulings against a dealership which alleged violations of Minnesota distribution and dealership laws. *North Star Int'l Trucks, Inc. v. Navistar, Inc.*, 2013 Minn. App. Unpub. LEXIS 294 (Minn. Ct. App. Apr. 8, 2013). In this case, a franchised truck dealership, North Star, alleged that truck manufacturer Navistar violated the dealership agreements between the parties as well as Minnesota's laws against unfair practices by manufacturers, changing the competitive circumstances of a dealership agreement without good cause, and price discrimination. The alleged offending conduct by Navistar included shrinking North Star's exclusive territory, establishing a new dealer in the former territory, and discriminatorily offering pricing discounts. At the conclusion of trial, dealer North Star was denied all relief sought.

The court of appeals affirmed the trial court's finding that North Star had waived its statutory claim by failing to dispute the reduction in its territory for twelve months, and by lodging written objections to other conduct without addressing the territorial reduction. It also affirmed the trial court's finding that Navistar had good cause to change the competitive circumstances of the dealership because North Star had not complied with several provisions of the parties' dealership agreement. The relevant provisions of the agreement were found to be "essential," "reasonable," and "uniformly" imposed, which thereby satisfied the statute's "good cause" requirement. The court rejected North Star's argument that Navistar's failure to enforce the cited provisions against other dealerships negated "good cause." Finally, the appellate court affirmed the trial court's conclusion that North Star was not entitled to injunctive relief on its pricing discrimination claims because the discrimination had stopped, adequate legal remedies existed for it in the form of damages, and North Star failed to show irreparable harm because its dealership agreement had not been terminated.

STATE APPEALS COURT HOLDS THAT TERMINATED DISTRIBUTORS CANNOT ASSERT CLAIMS UNDER THE TEXAS DECEPTIVE TRADE PRACTICES ACT

The Court of Appeals of Texas has reversed a trial court ruling and held that terminated distributors could not assert claims against their supplier under the Texas Deceptive Trade Practices Act (DTPA). *AdvoCare Int'l, L.P. v. Ford*, 2013 Tex. App. LEXIS 1162 (Tex. Ct. App. Feb. 5, 2013). After AdvoCare (a supplier of Ephedra® and certain other products) terminated their distributorships, several of the distributors filed suit alleging various claims including violations of the DTPA. At trial, a jury awarded them damages and attorneys' fees under that claim. The court of appeals reversed the judgment, finding that the distributors did not qualify as "consumers" and therefore could not bring a claim under the DTPA. The DTPA excludes those relationships that convey only intangible property rights, such as arrangements with distributors and sales representatives. Moreover, claims under the DTPA must be based on damages tied to an alleged defective product or service. Here, the sole basis for the distributors' claimed damages was the value of their distributorships as of the date AdvoCare terminated them. Therefore, the distributors could not state a DTPA claim.

NEW HAMPSHIRE SUPREME COURT HOLDS SETTLEMENT OF TERMINATION DISPUTE VIOLATES STATUTE

An agreement by which an automobile manufacturer and its dealer resolved a termination dispute violated New Hampshire's dealer protection statute, the state's highest court held this month. *Strike Four, LLC v. Nissan North America, Inc.*, 2013 N.H. LEXIS 37 (N.H. April 12, 2013). After Nissan originally sent a notice of termination, which its dealer protested, the parties reached a settlement by which the dealer would be given a new two-year contract but would be required to sell or lose its dealership without protest if any future defaults or breaches occurred, including the failure to meet sales goals. When Nissan later invoked the agreed forced-sale provisions because of slow sales, the dealer protested again and lost, then filed suit in state court and won. Nissan appealed to the state's high court.

The New Hampshire Supreme Court's decision affirming the decision in favor of the dealer turned on the court's finding that private parties cannot contractually agree to a termination process that contradicts the state's statutory protections for dealers. First, the dealer was not estopped from challenging the forced-sale provision simply because the dealer had agreed to it. And, the anti-waiver language of the New Hampshire statute rendered unenforceable the agreement regarding future termination conditions. The key statutory language limited discontinuance of a dealer regardless of the terms of "any agreement or franchise, and notwithstanding the terms or provisions to any waiver." Because the parties' settlement agreement had eliminated the dealer's protest rights and other protections, it was held invalid.

VICARIOUS LIABILITY

OKLAHOMA APPELLATE COURT REVERSES FINDING OF AGENCY RELATIONSHIP BETWEEN FORD MOTOR COMPANY AND DEALER

An Oklahoma appellate court rejected a trial court's decision that had found Ford Motor Company vicariously liable to disgruntled customers of a now-defunct dealership. *Thornton v. Ford Motor Co.*, Bus. Franchise Guide (CCH) ¶ 15,020 (Okla. Civ. App. Feb. 7, 2013). The case involved an Oklahoma dealer that closed its business only seven months after Ford approved its purchase of the dealership. During the seven months of operation, the dealer's employees executed bogus checks and failed to deliver vehicles, title certificates, or to pay balances on trade-in vehicles. The disgruntled customers sued, and the trial court found Ford vicariously liable under an agency theory and directly liable for approving the transfer of the business to an inexperienced and undercapitalized dealer.

The appellate court reversed, holding that Ford's reasonable control over its trademark did not create an agency relationship that rendered Ford vicariously liable for the dealer's bad acts. Other than showing that Ford controlled the trademarks, the disgruntled customers put forth no evidence demonstrating any indicia of control by Ford over the dealership. The appellate court relied on decisions from Oklahoma and other states, which decisions had held that a "manufacturer/franchisor may exercise some control or protect its national identity, reputation, and trademark from abandonment without creating an agency relationship with its dealer/franchisee." It also held that the dealership's display of Ford's trademark did not give Ford apparent authority. Finally, the appellate court reversed the trial court's finding of direct liability on the transfer, deciding that Ford owed no duty to the disgruntled customers under Oklahoma law.

DAMAGES

IOWA COURT DENIES DAMAGES AND ATTORNEYS' FEES TO DEALER THAT PREVAILED IN WRONGFUL TERMINATION SUIT

In *FECO, Ltd. v. Highway Equipment Co.*, 2013 Iowa App. LEXIS 94 (Iowa Ct. App. Jan. 9, 2013), the Iowa Court of Appeals affirmed a trial court's denial of damages and attorneys' fees to a prevailing plaintiff in a dealership termination suit. FECO had served as an agricultural equipment dealer for Highway Equipment before the latter terminated the parties' agreement in 2002. Highway Equipment admitted that it did not have good cause for termination and that it did not provide the necessary notice of termination, as required by the Iowa dealership statute. When considering damages, however, the trial court found that after the wrongful termination, FECO successfully began selling its own proprietary line of equipment and appeared to be in no worse position than it was before the termination. The court declined to award any damages because it found that FECO had fully mitigated any potential loss that arose from the termination of the dealership agreement. Because the court awarded no damages, it also declined to grant costs and attorneys' fees to FECO.

In affirming the trial court's ruling on mitigation, the Iowa Court of Appeals concluded that the trial court was not clearly erroneous in finding that Highway Equipment's damages expert was more credible than FECO's. The trial court noted that FECO's claim for damages of over four million dollars suffered from the thorough and damaging cross-examination of its expert, which questioning demonstrated that many of the numbers used in the expert's report were inconsistent with historical data, lacked factual support, or were simply wrong. The court concluded that reliance on this report "would require considerable speculation . . . without a sufficient base of data to support it." The court also concluded that it was proper for the trial court to consider Highway Equipment's evidence that FECO had fully mitigated its damages even though it did not specifically plead an affirmative defense of mitigation, because Iowa law only requires a defendant to plead a defense of *failure* to mitigate damages. The substantial evidence at trial supported the trial court's determination of expert credibility, and did not reflect an improper shift of the burden to disprove mitigation. Finally, the appellate court held that the trial court properly denied costs and attorneys' fees because the statute only provided for those costs "together with" actual damages, and did not permit an award of costs and fees standing alone.

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