The GPMemorandum

TO: **OUR FRANCHISE AND DISTRIBUTION CLIENTS AND FRIENDS**

FROM: **GRAY PLANT MOOTY'S FRANCHISE AND DISTRIBUTION PRACTICE GROUP**

Quentin R. Wittrock, Editor of *The GPMemorandum*

Jason J. Stover, Assistant Editor

DATE: **July 12, 2012—No. 157 (Distribution Issue)**

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

ANTITRUST

STATE COURT DECISIONS REFLECT CONTINUED LACK OF CONSISTENCY REGARDING TREATMENT OF VERTICAL RESALE PRICE MAINTENANCE

Last month saw two state appellate courts issue similar but not identical opinions regarding the treatment of vertical resale price (RPM) agreements. The decisions reflect the continued lack of consistency regarding the treatment of RPM under federal antitrust law and under various state antitrust laws, as well as the compliance difficulties faced by businesses with national resale networks.

On May 4, 2012, the Kansas Supreme Court in *O'Brien v. Leegin Creative Leather Products, Inc.*, 2012 Kan. LEXIS 246 (Kan. May 4, 2012), reversed a decision granting summary judgment to Leegin, holding that RPM agreements, whether in a purely vertical or dual distribution setting, are *per se* unlawful under the Kansas Restraint of Trade Act. The court acknowledged that following the United States Supreme Court's 2007 *Leegin* decision, both types of agreements would be analyzed under the "rule of reason" with respect to federal law. The court rejected, however, the applicability of federal antitrust law to claims brought under the Kansas antitrust statute.

The *O'Brien* decision follows the growing trend among states, including Maryland and California, to continue to treat RPM agreements as *per se* unlawful notwithstanding the rule of reason treatment of those same agreements under federal law.

Four days later, the Appellate Division of the New York Supreme Court, in *People v. Tempur-Pedic International, Inc.*, 2012 N.Y. App. Div. LEXIS 3528 (N.Y. App. Div. 1st Dep't, May 8, 2012), reached a somewhat different conclusion, affirming the dismissal of the New York Attorney General's complaint. That complaint alleged that RPM agreements are *per se* unlawful under New York state antitrust law. Unlike the Kansas Supreme Court, the New York court held that such agreements are not *per se* unlawful, just that they are unenforceable by statute.

These cases reflect the divergence between the treatment of RPM agreements under federal antitrust law and under the various state antitrust laws and highlight the importance of careful state-by-state analysis, drafting, and adherence to a *Colgate* policy for those businesses operating national resale networks.

FEDERAL COURT GRANTS SUMMARY JUDGMENT FOR DEFENDANT ON CLAIM OF MONOPOLIZATION

The United States District Court for the Eastern District of Virginia recently granted a manufacturer's motion for summary judgment on a claim of monopolization brought against it by a competitor. In *Kolon Industries, Inc. v. E.I. DuPont de Nemours & Co.*, Bus. Franchise Guide ¶ 77,857 (E.D. Va. Apr. 5, 2012), Kolon claimed that DuPont monopolized the United States para-aramid market, in which DuPont sold its Kevlar product, through the use of long-term, multi-year supply agreements with high volume para-aramid purchasers.

To prove its claim, Kolon had to show that DuPont possessed monopoly power and willfully acquired or maintained that power. In determining whether DuPont possessed monopoly power, the court assessed DuPont's market share and the durability of its power. The evidence showed that DuPont controlled no more than fifty-nine percent of the market during the relevant time period. The court noted that many courts have found that a market share of less than seventy percent is insufficient to support a claim of monopolization. The court also found that DuPont's closest competitor had as much as a forty-four percent market share, and that DuPont's market share had been decreasing before and during the relevant time period, while its competitors' shares were increasing. In addition, it found that the supply contracts alleged did not foreclose a sufficient portion of the relevant market to constitute "willful maintenance" of DuPont's market share. Therefore, the court granted DuPont's motion for summary judgment on Kolon's claim for monopolization and its companion claim for attempted monopolization.

COVENANT AGAINST COMPETITION IN CONSULTANT AGREEMENT DOES NOT VIOLATE SHERMAN ACT

Mary Kay sued a former national sales director (the next level up from a Mary Kay consultant) for enforcement of a contractual covenant against competition. The director, Amy Dunlap, in turn brought a counterclaim against Mary Kay. Dunlap alleged that Mary Kay had violated Texas's Deceptive Trade Practices Act (DTPA) and further claimed that the noncompete agreement was an illegal restraint of trade under the Sherman Act. In *Mary Kay, Inc. v. Amy Dunlap*, 2012 U.S. Dist. LEXIS 86499 (N.D. Tex. June 21, 2012), the court addressed Mary Kay's motion to dismiss Dunlap's counterclaims.

In analyzing the DTPA claim, the court held that the DTPA only applies where there is (a) a consumer, who is (b) seeking or acquiring goods or services. The court began by analyzing the crux of the relationship, and found that under the Mary Kay Agreement, the "objective…is to provide Dunlap various intangible rights and privileges as a [director]; the objective is not to provide her with the facilities, equipment, or other necessary goods and services to operate a business as would a common franchisee." Although Dunlap might be able to argue that she acquired goods and services from Mary Kay, the court found that "Dunlap's allegations are still inadequate to show that she is a DTPA consumer… because the goods or services allegedly acquired do not form the basis of the complaint."

As for the Sherman Act claim, Dunlap alleged that the noncompete vertically restrained trade by prohibiting Mary Kay consultants from participating in selling "cosmetic products similar to [Mary Kay's] line of cosmetic products, particularly in, but not limited to, the Texas market." The court dismissed this claim, stating that "[s]uch broad descriptions do not contain the factual specificity required for the court to draw the reasonable interference that Mary Kay is liable for the misconduct alleged." The court therefore granted Mary Kay's motion to dismiss both counterclaims.

<u>DAMAGES</u>

CONTRACTUAL AMBIGUITY CAUSES COURT OF APPEALS TO REMAND $1.9 BILLION DAMAGES AWARD

An appeals court in Ohio has set aside for now a large class action damages award that had been entered against an automobile manufacturer. In *Westgate Ford Truck Sales, Inc. vs. Ford Motor Company,* 2012 Ohio App. LEXIS 1707 (Ohio App. 8th Cir. May 3, 2012), the court reviewed the terms of a discount program provided by Ford Motor

Company to the Plaintiff-Appellee, Westgate Ford Truck Sales, and other dealers. Ford's Competitive Price Assistance Program (CPA) allowed dealers to petition Ford for discounts from the wholesale price of trucks in order to maintain a competitive edge in the market. The "Sales Advantage" CPA was available to all truck dealers whereas the "Appeal Level" CPA allowed for additional, need-based discounts on a case by case basis. Westgate claimed the contract required Ford to publish and provide any Appeal CPA discounts to all dealers. The trial court granted summary judgment in favor of Westgate on Ford's liability and awarded the plaintiff $1.9 billion. Ford appealed.

Unlike the trial court, the court of appeals held that the contract was ambiguous "when viewed as a whole" (though some terms within the key section were unambiguous). The court noted that Westgate had participated in and benefited from the Appeal CPA program without prior notice of rates provided to other dealers. The court questioned whether holding Ford liable for breach through strict adherence to the written contract would be contrary to the parties' past observance of the terms. The court quoted a prior Michigan case decision that a contract can be modified through course of dealing where there is "clear and convincing evidence of the parties' mutual intent to modify the contract." The court of appeals found that the trial court had abused its discretion in deciding that Westgate was entitled to summary judgment, and remanded the case for the fact finder to determine whether or not the contract was breached given the parties' course of conduct.

THE SIXTH CIRCUIT UPHOLDS LOWER COURT'S ALLOCATION OF A JURY'S DAMAGES AWARD

In *Laethem Equipment Company, et al. v. Deere & Company*, 2012 U.S. App. LEXIS 12135 (June 13, 2012), the U.S. Court of Appeals for the Sixth Circuit held that Michigan's comparative-fault scheme did not require a reduction in the jury's award of damages to the plaintiffs – two agricultural dealerships and their owners – and the Michigan Farm and Utility Equipment Act ("MFUEA") did not require the dealerships to make an election of remedies between their breach of contract claims and their statutory claims.

Francis Laethem owned and operated two agricultural dealerships for many years and, shortly before his death, put the dealerships' stock into a Trust. Upon Francis' death, his children (Michael, Mark, and Kathryn Laethem) became the beneficiaries of the Trust and Michael and Mark were given authority to operate the two dealerships. A dispute arose among the siblings regarding the ownership of the dealerships, which eventually led Deere to terminate them (allegedly in conjunction with Kathryn). The brothers and the two dealerships filed suit against Deere in the U.S. District Court for the Eastern District of Michigan, alleging, among other things, breach of contract, tortious interference with business relationships, and various violations of Michigan state laws. The jury returned a verdict for the dealerships and awarded damages.

On appeal, Deere argued that Michigan's comparative-fault scheme required a reduction of damages where the damages were a result of liability for contract as well as tort. On the tort claim, the jury had found that 65% of the fault was allocated to Deere and 35% of the fault was allocated to Kathryn Laethem, a non-party to the lawsuit. The Court of Appeals upheld the allocation of damages. It found that only one of the dealerships' theories of liability was subject to Michigan's comparative-fault scheme and that if Deere had been found liable only on that claim, the damages would have been reduced in proportion to the fault allocation. However, the court found that the damages award was also supported by two additional theories of liability that were not subject to the comparative-fault scheme, thus entitling the dealerships to a full recovery of damages without any reduction.

Deere also argued that the MFUEA required the dealerships to elect recovery either on their breach of contract claim or their statutory claim, but not both. The Court of Appeals disagreed. It found that the MFUEA provides for two types of remedies: an inventory buy-back remedy and a common law breach of contract remedy. It also found that the Act did not require the dealerships to choose between their two claims.

CONTRACTS

FOURTH CIRCUIT INTERPRETS CONTRACT INTEGRATION CLAUSE NARROWLY IN DECLINING TO EXCUSE OBLIGATIONS

In *Jaguar Land Rover North America, LLC v. Manhattan Imported Cars, Inc.*, 2012 U.S. App. LEXIS 8260 (4th. Cir. Apr. 23, 2012), the United States Court of Appeals for the Fourth Circuit affirmed a district court's summary judgment ruling in favor of an automobile supplier, holding that the supplier was not required to make certain incentive payments to the dealership. The appeals court declined to enforce a contract integration clause that purported to cancel and supersede any agreements previously executed between the parties.

In connection with their agreement to add a Land Rover franchise to an existing dealership, the parties entered into a program under which the dealership would receive incentive payments tied to the number of cars sold, as long as it made certain renovations to its facilities. The agreement was made up of three documents. The dealership's obligation to achieve certain renovation milestones appeared in the first two documents, while the third document provided for the incentive payments and contained an integration clause that purported to cancel and supersede all previous agreements. The parties executed the third document approximately two weeks after executing the first two documents.

When the dealership failed to meet its renovation milestones, Jaguar Land Rover suspended the incentive payments. Manhattan argued that it was not required to meet the renovation targets because the third document cancelled and superseded its renovation obligations. The Fourth Circuit disagreed. Under Maryland contract law, when separately executed contracts between the same parties do not have conflicting provisions and are entered into as part of a single transaction, those agreements will be construed together even when they are executed at different times and do not refer to each other. Therefore, the three documents comprised the parties' single agreement to add the Land Rover franchise to the dealership, and the integration clause contained in the third document did not apply to the first two documents.

TERMINATIONS

UNSIGNED CONTRACT DOES NOT CREATE BINDING COMMITMENT TO DISTRIBUTOR

The United States District Court for the Southern District of New York recently dismissed breach of contract and related claims brought against a manufacturer/supplier in connection with its termination of a long-time distributor because the parties had not signed a formal written distribution contract. In *National Gear & Piston, Inc. v. Cummings Power Systems, LLC,* 2012 U.S. Dist. LEXIS 72879 (S.D.N.Y. May 17, 2012), the defendant, a manufacturer and supplier of automotive components, had been selling products on a wholesale basis to the plaintiff-distributor since 1998. Although the parties had never entered into a formal written distribution agreement, the manufacturer sent its standard form of agreement to the distributor for signature in 2007. While the parties continued to do business together after that point, neither signed the form agreement.

According to the complaint, in 2009 the manufacturer changed the pricing structure under which it sold products to the distributor and prohibited the distributor from bidding on certain public transit authority supply contracts, allegedly reserving this business for itself. After the distributor violated that instruction, the manufacturer sent a written notice terminating the distribution relationship. The distributor then brought suit against the manufacturer, alleging that the unsigned distribution agreement was binding and that the manufacturer wrongfully terminated the relationship by failing to give sufficient detail regarding the distributor's default and by failing to advise it of its right to cure.

Finding in favor of the manufacturer, the court concluded that no binding contract existed between the parties. It noted that in considering whether a binding commitment exists when there is only an unsigned preliminary agreement between the parties, New York law considers the following factors: whether the contract expressly states that a written agreement must exist; whether all material terms have been agreed upon; whether there has been partial performance of the contract; and whether the agreement is of the type that is usually committed to writing. In determining that no contract existed between the parties, the court noted that although the distribution agreement specifically stated that the contract would become effective "upon the date fully executed" by both parties, neither party had actually signed the agreement. As a result, the court dismissed the distributor's breach of contract claim, along with several other causes of action that relied on the existence of a binding, ongoing agreement by the manufacturer to supply the distributor with products.

COURT AFFIRMS PRELIMINARY INJUNCTION PREVENTING TERMINATION OF DISTRIBUTORS

The Sixth Circuit Court of Appeals recently affirmed a preliminary injunction precluding a wine manufacturer from terminating two distributors as part of a nationwide reorganization plan. In *Tri-County Wholesale Distribs., Inc. v. The Wine Group, Inc.*, 2012 U.S. App. LEXIS 13415 (6th Cir. June 29, 2012), the court found that the plaintiff distributors were likely to prevail on the merits of their argument that The Wine Group did not have "just cause" to terminate them under the Ohio Franchise Act. The Act states that "just cause" requires more than "[a] unilateral alteration of the franchise by a manufacturer for a reason unrelated to any breach of the franchise or violation of [statutes]." The Sixth Circuit observed that the Ohio Court of Appeals recently issued a decision in another case involving The Wine Group which expressly agreed that "just cause must mean something more than a manufacturer's unilateral determination that it could make more money if a franchise were terminated."

The court also agreed that the distributors would suffer irreparable harm if terminated, given that they had distributed the products at issue for "decades" and had developed substantial goodwill related to their distribution of those products.

ARBITRATION

COURT COMPELS ARBITRATION AGAINST DISTRIBUTOR'S SPOUSE

In *Mac Tools v. Diaz*, U.S. Dist. LEXIS 56197 (S.D. Ohio Apr. 23, 2012), the U.S. District Court for the Southern District of Ohio enforced an arbitration provision against a distributor's wife even though she did not sign the distribution agreement at issue. Although the wife did not sign the agreement, she did invest personal funds in her husband's Mac Tools distributorship and participated in the acquisition and development of the business. When the distributorship failed, she brought suit against Mac Tools in state court, alleging that it had fraudulently induced her and her husband to purchase the business and had sold them an undisclosed franchise in violation of FTC regulations. After unsuccessfully attempting to remove the case to federal court, Mac Tools moved to compel arbitration pursuant to a clause in the distribution agreement. The distributor's wife countered that as a nonsignatory to the distributorship agreement, she could not be compelled to arbitrate. She also claimed that Mac Tools had waived its right to arbitrate her claims in the state court action.

In granting Mac Tools' motion, the district court found that the doctrine of equitable estoppel required the distributor's wife to arbitrate her claims against Mac Tools. The court reasoned that she was closely involved in the acquisition of the business and expected to financially benefit from the contract. In addition, her claims were substantively the same as her husband's potential claims against Mac Tools, and the evidence showed that she viewed the sale as a collective acquisition with her husband. Given these facts, the court held that it would be inequitable to permit her to litigate her claims in court when her husband would be bound to arbitrate those same claims. The court also held that Mac Tools had not waived its right to arbitrate by defending the state court lawsuit, as the manufacturer had moved expeditiously to have the claims against it moved to arbitration.

PETROLEUM MARKETING PRACTICES ACT

COURT REJECTS CLAIM UNDER PMPA BECAUSE PLAINTIFF NOT A FRANCHISEE

In *R+C+G Station v. Urbieta Oil, Inc.*, 2012 U.S. Dist. LEXIS 79033 (S.D. Fla. June 7, 2012), a Florida federal court held that the plaintiff was not a franchisee under the Petroleum Marketing Practices Act (PMPA). R+C+G Station (RCG), former operator of a Valero gasoline service station and convenience store, executed a three-year agreement with Urbieta Oil, Inc. Without notice, Urbieta terminated the parties' agreement and closed the location operated by RCG. RCG sued for violations of the PMPA, which limits the circumstances in which franchisors may terminate a service-station franchise or fail to renew a franchise relationship. Urbieta filed a motion to dismiss, alleging that RCG was not a franchisee under the PMPA.

The court had previously held that RCG was not a franchisee, noting that the parties' agreement expressly disclaimed the existence of a PMPA franchise relationship. RCG argued that, notwithstanding the disclaimer classifying it as an independent contractor and constructive retailer of petroleum products, it was actually a franchisee. The court disagreed, noting that the cases on which RCG relied required that an entity actually purchase gasoline from the franchisor. RCG did not purchase gasoline from the defendant or bear any relevant economic risk, but was merely responsible for receiving the fuel and acting as cashier. The court deemed those activities insufficient to qualify as a PMPA franchisee, and therefore dismissed the plaintiff's claim.

STATE FRANCHISE LAWS

WASHINGTON COURT HOLDS THAT A DEDUCTION FROM COMMISSION PAYMENTS MAY BE A FRANCHISE FEE

In *John R. Atchely and Michael Gilroy v. Pepperidge Farm, Inc.*, 2012 U.S. Dist. LEXIS 30878 (E.D. Wash. March 8, 2012), the United States District Court for the Eastern District of Washington found that a genuine issue of material fact existed as to whether Pepperidge Farm charged plaintiffs a franchise fee under the Washington Franchise Investment Protection Act by deducting from commissions owed to plaintiffs a fee for services related to a pallet delivery program. Under the program, Pepperidge Farm delivered shrink-wrapped pallets of bakery products directly to large purchasers' warehouses and deducted from those purchasers' standard commissions up to $35 to cover its cost of shrink-wrapping and delivery. Plaintiffs moved for summary judgment on their claim that the pallet delivery fee was a franchise fee under the Act.

Pepperidge Farm argued that the commission deduction was not a franchise fee because the fee deducted from the commissions was an ordinary business expense designed to recover its costs. On the other hand, plaintiffs argued that the deduction was actually a hidden franchise fee because it was a mandatory purchase of services. In addition, plaintiffs argued that Pepperidge Farm could not claim that the deduction fell under the exemption for the sale of goods at a bona fide wholesale price because the deduction was a charge for services provided and not for products sold. The District Court denied plaintiffs' motion, finding that a fact issue existed as to whether the deduction was a "mandatory purchase of goods or services," and thus a "franchise fee."

INTERNET ISSUES

WHAT FRANCHISE TRADEMARK OWNERS NEED TO KNOW ABOUT THE NEW INTERNET GENERIC TOP-LEVEL DOMAINS (gTLDs)

The Internet is undergoing a dramatic change that has significant implications for the use and protection of trademarks. June 13, 2012 marked "Reveal Day," when the international corporation that controls domain names, Internet Corporation for Assigned Names and Numbers (ICANN), published identifying information about applications for 1,930 new Generic Top-Level Domains (gTLDs).

Until now, web addresses have, for the most part, ended in such familiar gTLD extensions as .com, .net, and .org. There are currently 22 such extensions. There are also 280 country code Top-Level Domains (ccTLDs). In January 2012, ICANN launched a new program that allows public and private entities to establish gTLDs of their choosing using any letter and number combination (including non-ASCII characters used in foreign languages). Businesses can turn their own brand names into gTLDs, such as .microsoft, or form generic extensions based on product groups or geographic locations, such as .toys or .boston. The program significantly expands the Internet's Domain Name System (DNS) since there are now, theoretically, a virtually unlimited number of available gTLDs. Proposed gTLDs that pass the initial evaluation and face no formal objections could go into effect as early as next year.

Unfortunately, this innovation comes at a high price, as there is a serious potential for increased cybersquatting and other trademark-based concerns. Accordingly, brand owners in every industry need to understand the mechanisms available to protect their trademarks against infringement by the new gTLDs and, especially, by newly registered domain names within each of the new gTLDs.

The June 13 posting identifying the proposed new gTLDs triggered a sixty-day public comment period (ending on August 12, 2012), during which time anyone can submit feedback on active gTLD applications through a forum on ICANN's website.[1] During this time period, governments may issue an early warning objection to proposed gTLDs. For the next seven months, third parties will also be able to file formal objections to any application, using pre-established dispute resolution procedures.

Importantly, trademark owners will be able to file their marks with a centralized database, known as the Trademark Clearinghouse, to help protect them from infringement by new second-level domain names that are sought to be registered within the new gTLDs and from abusive conduct by gTLD operators. ICANN currently intends to open the Trademark Clearinghouse in October 2012.

Given the changing Internet landscape, brand owners need to be prepared to defend their trademarks against potential infringers in the new gTLDs. At a minimum, they should review the published list of proposed new gTLDs and consider whether a comment or formal objection is warranted. They should also, in most cases, register their important trademarks with the Trademark Clearinghouse when it is activated. Once certain of the new gTLD registries are activated, they should be added to the gTLDs and ccTLDs that a brand owner is currently monitoring for possible claims against domain name registrants or registry operators via established and newly created mechanisms.

---

[1] *See* http://newgtlds.icann.org/en/program-status/application-comments

Along with the attorneys indicated on the next page, summer associates D.J. Ringquist, Anjuanna Napune, and Karli Peterson contributed to Issue 157 of *The GPMemorandum*.

Minneapolis, MN Office

John W. Fitzgerald, cochair (612.632.3064)
Megan L. Anderson (612.632.3004)
Phillip W. Bohl (612.632.3019)
Jennifer C. Debrow (612.632.3357)
* Elizabeth S. Dillon (612.632.3284)
Ashley Bennett Ewald (612.632.3449)
* Michael R. Gray (612.632.3078)
Laura J. Hein (612.632.3097)
* Kelly W. Hoversten (612.632.3203)
Franklin C. Jesse, Jr. (612.632.3205)
Cheryl L. Johnson (612.632.3271)
* Jeremy L. Johnson (612.632.3035)
Gaylen L. Knack (612.632.3217)
Craig P. Miller (612.632.3258)

Kirk W. Reilly, cochair (612.632.3305)
Bruce W. Mooty (612.632.3333)
John W. Mooty (612.632.3200)
* Kevin J. Moran (612.632.3269)
Kate G. Nilan (612.632.3419)
Matthew G. Plowman (612.632.3425)
Angela L. Rud (612.632.3281)
Max J. Schott II (612.632.3327)
* Jason J. Stover (612.632.3348)
Michael P. Sullivan, Sr. (612.632.3351)
Michael P. Sullivan, Jr. (612.632.3350)
Henry Wang (612.632.3370)
Lori L. Wiese-Parks (612.632.3375)
* Quentin R. Wittrock (612.632.3382)

Washington, DC Office

* **Robert L. Zisk, cochair (202.295.2202)**
* Julia Colarusso (202.295.2217)
* Maisa J. Frank (202.295.2209)
* Jeffrey L. Karlin (202.295.2207)
* Peter J. Klarfeld (202.295.2226)
* Sheldon Klein (202.295.2215)

Iris F. Rosario (202.295.2204)
Stephen J. Vaughan (202.295.2208)
* Katherine L. Wallman (202.295.2223)
* David E. Worthen (202.295.2203)
Eric L. Yaffe (202.295.2222)
* Carl Zwisler (202.295.2225)

**** Wrote or edited articles for this issue.***

For more information on our Franchise and Distribution practice and for recent back issues of this publication, visit the **Franchise and Distribution** practice group at www.gpmlaw.com/practices/franchise-and-distribution.aspx.

GRAY PLANT MOOTY

500 IDS Center
80 South Eighth Street
Minneapolis, MN 55402-3796
Phone: 612.632.3000
Fax: 612.632.4444

Suite 700, The Watergate
600 New Hampshire Avenue, N.W.
Washington, DC 20037-1905
Phone: 202.295.2200
Fax: 202.295.2250

franchise@gpmlaw.com

GP:3199983 v1