The Defense of Terminated Dealer Litigation: A Survey of Legal and Strategic Considerations

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CHARLES J. FARUKI

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I. INTRODUCTION

Successful defense of actions for injunctive relief and damages brought by terminated dealers, distributors and franchisees frequently turns upon selection of the best procedural posture for defending the case. A reading of the complaint in these cases will usually reveal equities weighing heavily in favor of the dealer who claims to have been suddenly and mercilessly cut off from its only source of supplies after long and faithful service and good performance on behalf of the heartless and greedy manufacturer. The area of terminated dealer litigation is one in which conflicting public policies also exist. These conflicting policies include the strong public policy in favor of a manufacturer's right to sell to whomever it wishes and consequently to select the persons through whom it will sell its product, the public policies represented by the antitrust laws and by private enforcement of those laws, the public policy in favor of arbitration as a method of resolving disputes, and the public policies in favor of arbitration as a method of resolving disputes, and the public policies

1. Although the terms dealer, distributor, and franchisee are each capable of different meanings this Article's analysis applies to each. The law applicable to a dispute, however, may depend upon the status of the plaintiff, such as when a franchise protection statute or a dealer protection act is applicable. Moreover, in certain areas, such as the law governing injunctive relief, the outcome of litigation can be different depending upon which of these categories includes the plaintiff. A distributor that carries many lines may have great difficulty in obtaining preliminary injunctive relief to prevent the termination of a distributorship agreement for a line of goods that represents but a small portion of its sales. See, e.g., Grand Light & Supply Co. v. Honeywell, Inc., 80 F.R.D. 699, 702 (D. Conn. 1978) (motion for a preliminary injunction against the termination of a distributorship agreement denied because plaintiff failed to show substantial harm resulting from the termination; plaintiff derived only $115,000 of a $6 million annual operation from the defendant's product line).

2. For elaborate descriptions of these equities, see Brown, Franchising—A Fiduciary Relationship, 49 Tex. L. Rev. 650 (1971); Gellhorn, Limitations on Contract Termination Rights—Franchise Cancellations, 1967 Duke L.J. 465, 467-73. A successful reliance upon these equities is found in Semmes Motors v. Ford Motor Co., 429 F.2d 1197, 1205 (2d Cir. 1970), which affirmed a preliminary injunction against termination of a dealership. It should be noted, however, that the Second Circuit limited Semmes to its facts in Jack Kahn Music Co. v. Baldwin Piano & Organ Co., 604 F.2d 755, 761 (2d Cir. 1979). But see Ryko Mfg. Co. v. Eden Servs., 759 F.2d 671, 673 (8th Cir. 1984); Roto-Lino Beverage Distrb. v. Coca-Cola Bottling Co., 749 F.2d 124 (2d Cir. 1984) (citing Semmes and holding that loss of distributorship which was the livelihood of husband and wife for years was irreparable harm).


represented by the strict standards governing the availability of injunctive relief.5

The purpose of this Article is to survey the most common issues and strategies in the defense of such cases. This Article will also show certain pitfalls to avoid in setting up a distribution system and in drafting franchise or dealership agreements.6

The first section of this Article discusses the dealership agreement. This contract between the parties is the starting point for identifying their respective rights and responsibilities. Many of the issues in terminated-dealer litigation involve the central provisions of the dealer agreement: the duration of the agreement, notices required to be given under it, nonrenewal and termination provisions, forum selection clauses (including arbitration agreements), and limitations upon remedies. The second section of this Article discusses bodies of substantive law that apply to disputes arising upon termination of dealers. The third section of this Article discusses remedies typically sought in terminated-dealer cases (preliminary injunction, specific performance, and damages) as well as the procedural arguments that may be employed to defend a terminated-dealer case. All of these subjects are treated in the context of the typical “wrongful termination” case in which a distributor has received notice of nonrenewal or termination of its agreement and files suit in state or federal court seeking injunctive relief, damages, or both. Additionally, in many instances, counsel will be contacted by the manufacturer before a decision is made to send notice of nonrenewal or termination.

II. THE FIRST STEP: ANALYSIS OF THE DEALERSHIP AGREEMENT

Frequently, the best defense to a terminated-dealer action is found in the dealership contract itself and is thus difficult for the plaintiff to overcome.7 A dealer

5. Mason County Medical Ass’n v. Knebel, 563 F.2d 256, 261 n.4 (6th Cir. 1977) (rejecting “possibility of success on the merits” as one of four standards for preliminary injunctive relief, and requiring that “the plaintiffs must demonstrate a strong or substantial likelihood or probability of success on the merits.” (emphasis in original)).

6. The drafting of distribution agreements is discussed in Van Cise, A Franchise Contract, 14 Am. Bus. L.J. 325 (1969). A checklist of facts and questions to be reviewed with a client contemplating a prospective dealership termination or nonrenewal is provided at the conclusion of this Article, infra p. 998.

7. For example, under Ohio law, an unambiguous written agreement does not become ambiguous simply because its operation will work a hardship on one of the parties. S & M Constructors v. City of Columbus, 70 Ohio St. 2d 69, 71, 434 N.E.2d 1349, 1351 (1982) (citing Ohio Crane Co. v. Hicks, 110 Ohio St. 168, 143 N.E. 385 (1924)). Moreover, cases have held that a plaintiff’s failure or refusal to read the language of an agreement does not release the plaintiff from obligations under it. Stanley A. Klopp, Inc. v. John Deere Co., 510 F. Supp. 807, 811 (E.D. Pa. 1981) (holding that plaintiff dealer whose contract had been terminated could not recover future profits after manufacturer breached dealership agreement because of provision barring recovery of future profits upon termination of dealership), aff’d mem., 676 F.2d 688 (3d Cir. 1982); Accord Operating Eng’rs Pension Trust v. Gilliam, 737 F.2d 1501, 1504 (9th Cir. 1984); Quality Foods v. United States Fire Ins. Co., 715 F.2d 539, 542 (11th Cir. 1983); Saavedra v. Donovan, 700 F.2d 496, 500 (9th Cir. 1983), cert. denied, 464 U.S. 892 (1983); Mercury Coal & Coke v. Mannesmann Pipe & Steel Corp., 696 F.2d 315, 318 (4th Cir. 1982); Vernon v. Drexel Burnham & Co., 52 Cal. App. 3d 706, 714, 125 Cal. Rptr. 147, 151 (1975) (reversing denial of a petition for arbitration in which the plaintiff contended that he was unaware of the arbitration clause because he did not read it).

Furthermore, not only is the intention of the parties to a written contract to be ascertained from the writing itself, but also “it is their intention as it existed at the time the contract was executed which must control rather than any subsequent intention tailored to complement an individual’s posture once an agreement has gone sour.” New Eng. Merchants Nat’l Bank v. Inn Power Generation & Transmission Co., 502 F. Supp. 120, 127 (S.D.N.Y. 1980). Accord Payroll Express Corp. v. Astina Casualty & Sur. Co., 659 F.2d 285, 291 (2d Cir. 1981); Corenswet, Inc. v. Amana Refrigeration, 594 F.2d 129, 132 (5th Cir.) (“As is so often the case with franchise and distributorship relationships, the termination clause in the standard form contract was of little interest or concern to the parties so long as things were going well between them.”), cert. denied, 444 U.S. 938 (1979).
agreement usually includes the following terms and conditions that are frequently significant during litigation: the duration of the agreement; dealer requirements by way of satisfactory performance under the agreement; notice requirements; integration clauses; provisions regarding nonrenewal or termination, both as to the grounds for such action and as to the method by which it should be accomplished; forum selection provisions, including arbitration agreements; and limitations upon remedies.

A. The Duration of Distributorship Agreements

Ordinarily the duration of a distributorship is specified in writing, and is for a definite term. However, much litigation has resulted from the fact that many distributorships or exclusive sales agency contracts are oral or are written without reference to a term. The better practice is for the dealer agreement to specify in writing the duration of the dealer's appointment, the method of termination, the period of notice required, and the method of giving the notice required.

When a dealer agreement is oral, or is silent as to its duration, the plaintiff dealer typically claims inadequate notice of termination, detrimental reliance (by expenditures for improvements to its facilities, and by purchases of large quantities of inventory or spare parts) upon the defendant manufacturer's continuation of the distributorship, and possible ruin due to sudden, unexpected cancellation. The dealer may then argue that its actions in anticipation of continued required efforts on its part should protect it from an abrupt or premature termination. This argument may be supported by cases holding that contracts providing for termination upon the occurrence of a specific event are not terminable at will and may not be terminated except upon the occurrence of the specified event.8

Courts do not favor contracts of perpetual or unlimited duration; if a contract is silent as to its term, courts will not imply that a contract is of unlimited duration.9 In

8. See, e.g., Ehrenworth v. Stuhmer & Co., 229 N.Y. 210, 128 N.E. 108 (1920) which involved a distributorship contract that provided that it was to last "as long as the plaintiff and Stuhmer & Co. remained in business," id. at 214–15, 128 N.E. at 108. In rejecting the defendant's contention that it was not bound by the agreement because the contract lacked mutuality, the court found that the agreement had "every element of a contract" including a term governing its "duration," id. at 218, 128 N.E. at 110. The fact that the duration was for as long as the parties remained in business posed no problem because "this court has had no difficulty in approving contracts made to last through the life of one of the parties." id. at 220, 128 N.E. at 110. Accord Warner-Lambert Pharmaceutical Co. v. John J. Reynolds, Inc., 178 F. Supp. 655, 662–63 (S.D.N.Y. 1959), aff'd per curiam, 280 F.2d 197 (2d Cir. 1960); Ketcham v. Hall Syndicate, 37 Misc. 2d 693, 699, 256 N.Y.S.2d 206, 212 (Sup. Ct. 1962) (rejecting plaintiff's attempt to terminate a contract to produce and deliver cartoons on the ground that the contract contained an indefinite term because the contract was not indefinite as to its duration), aff'd mem., 19 A.D.2d 611, 242 N.Y.S.2d 182 (1963); United Chem. & Exterminating Co. v. Security Exterminating Corp., 246 A.D. 258, 259, 285 N.Y.S. 291, 292 (1936) (an agreement providing that it was to continue in full force and effect until cancelled by the consent of both the parties was not terminable at will, "even though it is impossible to predict exactly when the contingency will occur by which it will be terminated.").

Recently the Second Circuit reviewed these cases in determining that "New York's policy against perpetual commitments" does not apply to agreements that provide for termination upon occurrence of specified events. Payroll Express Corp. v. Aetna Casualty & Sur. Co., 659 F.2d 285, 291–92 (2d Cir. 1981). Therefore, since most distribution agreements include provisions regarding termination upon the occurrence of listed events, the rule against perpetual contractual commitments should not apply to such agreements.

9. William B. Tanner Co. v. Sparta-Toman Broadcasting Co., 716 F.2d 1155, 1159 (7th Cir. 1983). Accord United States Surgical Corp. v. Oregon Medical & Surgical Specialties, 497 F. Supp. 68, 71 (S.D.N.Y. 1980) (a perpetual obligation is not inferred from the absence of date of termination; if parties intend perpetual duration, they must expressly say so; if no duration is stated, contract is for a reasonable time, in this case, four to five years); Brownboro Rd. Restaurant, Inc. v. Jerrico, Inc., 1985-1 Trade Cas. (CCH) ¶ 66,561 (Ky. App. 1984).
DEFENDING TERMINATED DEALER LITIGATION

Haines v. City of New York, one of the leading cases on the subject, the New York Court of Appeals held that contracts of exclusive agency or distributorship are terminable at will. Furthermore, the Seventh Circuit has noted, "Courts are reluctant to interpret contracts providing for some perpetual or unlimited contractual right unless the contract clearly states that that is the intention of the parties." Similarly, the Third Circuit has stated, "A franchise is not a marriage for life."

Most modern authorities agree that dealer agreements are terminable at will. In Aaron E. Levine & Co. v. Calkraft Paper Co., for example, the court, in a suit by a paper broker against a paper mill and its parent corporation for alleged breach of contract and alleged wrongful termination of the distributorship, held that a distributorship contract was terminable at will and that reasonable notice of termination was given. Rejecting the concept of a common law duty not to terminate a distributorship agreement, the court recognized that the Uniform Commercial Code requires that reasonable notice be given, and that what constitutes that notice depends upon the circumstances in each case. The court then held that since the paper mill had advised the distributor beginning ten months earlier of the likelihood of termination, and had given him the names of competing mills that the distributor could call in an attempt to get a new affiliation, plaintiff had sufficient notice to enable him to find a new source of supply and thus had reasonable notice of the termination, even though formal notice of termination had never been given.

More recently, the Ninth Circuit, using an analysis similar to that set forth in Aaron E. Levine & Co., relied upon the Uniform Commercial Code to decide Zidell Explorations v. Conval International, Ltd. The court applied principles usually

The opinion in Tanner also contains a discussion of the distinction between disputes over expressing and disputes arising from omission in contract interpretation. "That is, the problem of interpreting the meaning which parties intend contractual terms to have is distinct and should be considered separately from the problem of construing the scope of a contract." William B. Tanner Co. v. Sparta-Toman Broadcasting Co., 716 F.2d 1155, 1158 (7th Cir. 1983) (emphasis in original). See also Joe Regueira, Inc. v. American Distilling Co., 642 F.2d 826, 829-30 (5th Cir. 1981) (granting summary judgment against plaintiff wholesale distributor whose alleged oral agreement with defendant had been terminated on 30 days' notice; court distinguished, under Florida law, between indefinite contract (one wholly lacking in reference to its duration) that was terminable at will upon reasonable notice, and a perpetual contract that may continue perpetually under an agreed duration term). Cf. C.A. May Marine Supply Co. v. Brunswick Corp., 557 F.2d 1163, 1165 (5th Cir. 1977) (distinguishing between construction and interpretation of contract in dealer's wrongful termination action); Haines v. City of New York, 41 N.Y.2d 769, 773, 364 N.E.2d 820, 823 (1977) ("Having determined the duration of the city's obligation, the scope of its duty remains to be defined.").

11. Id. at 772, 364 N.E.2d at 822 (1977). Accord Northeastern Wholesalers v. Owens-Corning Fiberglass Corp., 24 Misc.2d 165, 198 N.Y.S.2d 945, 946 (Sup. Ct. 1960) (dismissing an action involving an exclusive sales contract which said that it was to continue so long as the plaintiff's sales in the assigned areas constituted a reasonable percentage of the defendant's total production; the contract was held to be of indefinite duration and therefore terminable at will). Cf. Copy-Data Sys., Inc. v. Toshiba Am., Inc., 755 F.2d 293, 301 (2d Cir. 1985).
16. Id. at 1051.
17. Id.
18. Id.
20. 719 F.2d 1465 (9th Cir. 1983).
applied to the question of termination of distributorship agreements without a specified duration: If the agreement does not contain a definite ending date, it is terminable at will by either party subject only to the obligations of reasonable notice and good faith. Although the court in Zidell Explorations indicated that fulfillment of the notice and good faith requirements presents a jury question, summary judgment is appropriate to resolve this issue when there are no disputed issues of material fact. These cases also raise the issue of whether the notice period is sufficient to enable the terminated distributor to search for or obtain alternative sources of supply. That issue is treated in the next section of this Article.

Some courts apply an exception to the termination-at-will rule, the recoupment doctrine, when the dealer has made a substantial investment in reliance upon continued performance under the distributorship agreement. Two Eighth Circuit cases decided on the same day are illustrative. McGinnis Piano & Organ Co. v. Yamaha International Corp. held that distribution agreements which contain no provisions for duration or termination contain an implied provision of reasonable duration when the dealer has made substantial investments in reliance upon the agreement. Additionally, the notice period must afford the dealer a sufficient opportunity to recover its investment. The court defined this period as a "period of time necessary to close out the franchise and minimize losses." The principle underlying the recoupment doctrine is that a reasonable duration will be implied in a dealer agreement to allow the dealer to recover its initial investment. The question of reasonable duration is for the jury. Under the recoupment theory, however, the measure of damages is limited to the unrecouped investment, and includes neither lost future profits nor normal operating expenses.

Ag-Chem Equipment Co. v. Hahn, Inc., another Eighth Circuit case, made clear that the doctrine of recoupment applies only when the contract is terminable at will and only to "a distributorship requiring one, large, initial investment." As these decisions demonstrate, the doctrine of recoupment is a limited exception to the termination-at-will rule.

21. Id. at 1473–74.
22. Id.
23. Fed. R. Civ. P. 56(c); RJM Sales & Mkts. v. Banfi Prods. Corp., 546 F. Supp. 1368 (D. Minn. 1982) (under Minnesota law, no "wrongful termination" of wine distributor because unambiguous termination clause requiring thirty days written notice created a contract terminable at will and did not require cause for termination; summary judgment granted to defendant).
25. 480 F.2d 474, 479 (8th Cir. 1973) (applying Minnesota law).
26. Id. at 479.
29. Id. at 481–82.
30. 480 F.2d 482 (8th Cir. 1973) (reviewing cases from various jurisdictions).
31. Id. at 487, 492.
32. Id. at 487.
A third line of cases holds that distribution agreements are terminable only upon reasonable notice. In other words, a contract granting a dealership for an indefinite duration continues for a reasonable time, and is not terminable at will. Perhaps the leading case is *Des Moines Blue Ribbon Distributors v. Drewrys Ltd.*, an action by a beer distributor against the brewery for damages resulting from cancellation of the beer distributorship agreement. There, the court held that the cancellation without notice by the brewery gave rise to damages equal to the amount of sales that the distributor would have made during a reasonable time period following receipt of notice of termination of the distributorship agreement. The court rejected the defendant’s argument that the agreement was terminable at will, holding that it “will continue for a reasonable time and may be terminated without cause only upon reasonable notice.” The court reasoned that damages are recoverable for the period of reasonable notice that was not given. Sometimes courts apply a hybrid of two of the above rules, and hold that a contract is terminable at will if reasonable notice is given.

Although distributorship agreements should be terminable at will if they do not specifically provide a period of duration, the manufacturer, in anticipation of future termination possibilities, should plan for the contingency of litigation. Ordinarily, the manufacturer is better served by ensuring its customers continuous service. Although a distribution agreement should properly be considered to be terminable at will, interests in uninterrupted service to customers and preparation for litigation make it prudent for the manufacturer to provide reasonable notice of termination.

**B. The Significance of Notice Requirements**

Notice requirements in distribution agreements serve several purposes. First, requiring notice before termination helps to minimize the distributor’s losses by giving the distributor the opportunity to seek alternative sources of supply, liquidate inventory, avoid being stuck with large quantities of product or spare parts that he will not be able to market effectively, and make other necessary adjustments to his business. Conversely, the notice of termination informs the distributor of the approaching fact of cancellation, and triggers his duty to mitigate damages. A notice period also helps to maintain service to the customers of the distributor and the manufacturer by enabling both to plan how best to serve customers in the future. In these ways, the notice provisions of a contract provide the parties with certainty in their relationship.

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33. 256 Iowa 899, 129 N.W.2d 731 (1964).
34. Id. at 908-99, 129 N.W.2d at 737.
35. Id. at 906, 129 N.W.2d at 736.
36. Id. at 908-99, 129 N.W.2d at 737. Accord Cornsweet, Inc. v. Amana Refrigeration, 594 F.2d 129, 139 (5th Cir.) (citing Drewrys and holding that a claim "based on inadequate notice would not entitle [plaintiff] to injunctive relief" because "the manufacturer's failure to give proper notice is adequately remediable at law."). cert. denied, 444 U.S. 938 (1979).
37. McCasland v. Prather, 92 N.M. 192, 196-97, 585 P.2d 336, 340-41 (Ct. App. 1978). In that case the court stated that § 2-309 of the Uniform Commercial Code provides that "a contract is terminable at will upon reasonable notification." Id. at 197, 587 P.2d at 341. The dissent argued that the contract was terminable at will, relying in part upon the law of distributorship contract terminations. Id. at 197-98, 585 P.2d at 341-42.
In general, a party that terminates an agreement need not state the reasons for termination, unless the contract itself requires it do so. In Contemporary Mission v. Famous Music Corp., the Second Circuit held that a written notice constituted adequate compliance with the notice requirement in a contract granting the exclusive right to distribute certain records in the United States:

Famous also maintains that, even if there were a breach, Contemporary is barred from asserting it, because it failed to adequately comply with the notice requirement contained in the Crunch agreement. We find this argument unpersuasive... it would be hyper-technical to upset the verdict on the ground that the notice was insufficient. We decline to construe the notice provision as if it were a common law pleading requirement under which every slip would be fatal. The purpose of the written notice requirement was to permit Famous within 30 days to cure any material breach.

The Second Circuit’s reluctance to entertain a “hypertechnical” construction of a notice provision is a typical judicial response. The dissent in Contemporary Mission vigorously disputed the majority’s reasoning regarding notice of breach, and stated that a provision permitting a cure of a material breach within thirty days after receipt of written notice of such breach should preclude recovery unless such notice has been given.

Further, notice is not invalidated by the fact that it is not sent by the method required in the agreement. The Fifth Circuit so held in Sports Center v. Riddell, Inc., in which a sports equipment manufacturer terminated its dealer agreement by a letter sent by ordinary mail, instead of “by registered mail” as required by the distributor agreement.

The general rule is that the termination of a distributorship of an indefinite or unspecified term must be preceded by reasonable notice. The Ninth Circuit in Sierra Wine & Liquor Co. v. Heublein, Inc. reasoned that a reasonable notice requirement is appropriate for a distributorship with no express duration, and that the lack of such notice supported a right to recover six months’ profits.

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38. Measday v. Kwik-Kopy Corp., 713 F.2d 118, 126 n.6 (5th Cir. 1983) (quoting Restatement (Second) of Contracts § 248 comment b (1979)).
39. 557 F.2d 918, 925 (2d Cir. 1977).
40. Id. at 925 (footnotes omitted; emphasis added).
41. See, e.g., McGowan v. DM Group IX, 7 Ohio App. 3d 349, 455 N.E.2d 1052 (Franklin County Ct. App. 1982).
43. However, it is an issue of fact whether the manufacturer provided proper notice before termination, and this issue can preclude the grant of summary judgment. Carlson Mach. Tools v. American Tool, 678 F.2d 1253, 1263 (5th Cir. 1982).
44. 673 F.2d 786 (5th Cir. 1982).
46. Copy-Data Sys., Inc. v. Toshiba Am., Inc., 755 F.2d 293, 301 (2d Cir. 1985); First Flight Assocs. v. Professional Golf Co., 527 F.2d 931, 935 (6th Cir. 1975) (“contracts silent on time of termination are generally terminable at will by either party with reasonable notice;” five month notice was held reasonable). This principle has been called “the majority rule” in Sierra Wine & Liquor Co. v. Heublein, Inc., 626 F.2d 129, 131 (9th Cir. 1980). See generally Annot., 19 A.L.R.3d 196 (1968); Matheus v. Tombstone Pizza Corp., Bus. Franch. Guide (CCH) ¶ 7619 (Wis. App. 1981) (collecting cases).
47. 625 F.2d 129, 131–32 (9th Cir. 1980).
The sufficiency of the period of time for notice depends upon the circumstances of each case. One court has held that notice of approximately ten months was sufficient in that case, but emphasized that the circumstances of each case are important, and cited two cases involving distributorships of thirteen years duration, in which notices of four months and of two weeks were upheld. Some cases have held that a six month period of time is sufficient to give the terminated distributor time to obtain alternative supplies.

C. Nonrenewal and Termination Provisions

This section of the Article deals with the methods of accomplishing termination or nonrenewal decisions. A fundamental distinction must be drawn between nonrenewal and termination of a distribution agreement. Nonrenewal of an agreement implies the expiration of an agreement by its own terms, whereas termination is the affirmative act of ending an agreement. The difference in the two concepts is significant because it implies a difference in the burden of proof if there is a disagreement about the legality or justification for the action. To show that a nonrenewal decision was unjustified or unlawful, the burden should be on the aggrieved distributor. In contrast, in a termination situation, the burden of persuasion does not shift to the defendant manufacturer, but the defendant manufacturer may have the burden of going forward with evidence to support a termination decision. There may also be differences regarding notice requirements. Courts recognize the distinction between termination and nonrenewal with varying degrees of precision.

From the standpoint of drafting a dealer agreement or of setting up a distribution system, the manufacturer should demonstrate a strong preference for a nonrenewal system. Mutual termination provisions should be included as well to cover situations such as the death or incapacity of the principals of the dealer; any substantial change in the ownership, control, or management of either party; failure to pay indebtedness when due; dishonesty; bankruptcy or insolvency; and litigation between the parties.

49. Newport Tire & Rubber Co. v. Tire & Battery Corp., 504 F. Supp. 143, 148, 152 (E.D.N.Y. 1980) (in a case handled by the author, the notice of termination offered the plaintiff six months of continued association with the defendant to ease the plaintiff’s transition to alternative forms of tire supply; the court concluded that a six month period would give plaintiff sufficient time); Lee-Moore Oil Co. v. Union Oil Co., 441 F. Supp. 730, 737-39 (M.D.N.C. 1977) (two months notice of intention not to renew agreement on the next upcoming anniversary date of the agreement, coupled with extension of the plaintiff’s supply for an additional six months, was sufficient to mitigate effect upon plaintiff; the court also rejected the plaintiff’s argument that a comparable source meant a source of a comparable brand); Bos Material Handling v. Crown Controls Corp., 137 Cal. App. 3d 99, 104, 186 Cal. Rptr. 740 (1982) (in another case handled by the author, a one month notice of non-renewal was softened by an offer to defer expiration of the agreement by an additional month).
51. See, e.g., Spray-Rite Serv. Corp. v. Monsanto Co., 684 F.2d 1226, 1233 n.2 (7th Cir. 1982), aff’id on other grounds, 465 U.S. 752 (1984); Brattleboro Auto Sales v. Subaru Inc., 653 F.2d 649, 650 n.2 (2d Cir. 1980); J.H. Westerbeke Corp. v. Onan Corp., 480 F. Supp. 1173, 1184 (D. Mass. 1984) (“At the outset, and to put this matter into perspective, this is not a dealer termination case. The challenged activity here is Onan’s decision not to renew Westerbeke as its distributor.”); Pinoe-Bowers, Inc. v. Mestre, 517 F. Supp. 52, 64 (S.D. Fla.), cert. denied, 104 S. Ct. 237 (1981) (where agreement used terms “expiration” and “termination” they have “distinct, if not mutually exclusive, meanings.”).
Three issues remain with respect to the enforcement of termination or nonrenewal provisions. First, must such provisions be followed? Second, who must be satisfied that the provisions for termination are met; is the standard objective or subjective? Third, are termination provisions the exclusive means by which an agreement may be terminated? The first question is easily answered; the cases typically hold that termination provisions must be followed. For example, when a distribution agreement required that disputes between the parties be submitted to arbitration prior to termination, the Second Circuit strictly enforced the conditions of that termination provision, and held that until the parties arbitrated their dispute, a preliminary injunction against the attempted termination was proper. Applying a classic benefit of the bargain analysis from the law of contracts, the court held that the plaintiff was entitled to have the defendant follow the termination procedures. Failure to comply with termination provisions is a breach of contract.

The next issue raises the question whether the appropriateness of a termination or nonrenewal is subject to an objective or subjective standard. If a distributorship agreement is considered to be akin to a contract for personal services, then the test of adequate performance should be whether the manufacturer in fact is satisfied, and not whether he ought to be satisfied. However, the distribution agreement may not permit termination upon the subjective dissatisfaction of the terminating party, but instead require application of an objective test (i.e., whether a reasonably prudent manufacturer, acting honestly, fairly, and in good faith would be dissatisfied).

The final issue regarding enforcement of termination provisions is whether such provisions constitute the exclusive method of terminating a distribution agreement. The best discussion of this subject is found in the Fifth Circuit's opinion in Olin Corp. v. Central Industries. The court summarized "the Corbin view" that a termination provision is the exclusive means of contract termination, and "the Williston view" that a termination provision does not bar termination for material breach unless it is

52. Guinness-Harp Corp. v. Jos. Schlitz Brewing Co., 613 F.2d 468, 473 (2d Cir. 1980); WICO Corp. v. Willis Indus., 567 F. Supp. 352, 354 (N.D. Ill. 1983) (rejecting an argument that the manufacturer did not breach distributorship agreements because the distributor failed to agree on sales quotas and to meet the sales quotas required by the agreements; "the termination procedures themselves still had to be followed.").
54. Id. at 473.
57. This was the test approved in Carlson Equip. Co. v. International Harvester Co., 710 F.2d 481, 482-83 (8th Cir. 1983) (affirming judgment for plaintiff dealer in the amount of $200,000, and holding that an objective standard applied to termination of the agreement).
58. See infra text accompanying notes 517-18, discussing the nature of distribution agreements as it bears upon the grant or denial of injunctive relief.
59. 576 F.2d 642 (5th Cir. 1978).
by its terms exclusive. The court chose the Williston view. This rule is a reasonable one in view of the fact that it is so difficult for the parties to an agreement to conceive of every possible ground for termination that may later arise.

D. The Choice of Law Provision

Distributorship agreements, like most commercial agreements of any length or complexity, contain a standard provision expressly designating the law to be applied in construing the agreement. These contractual choice of law agreements serve a number of important purposes: First, they add certainty to the parties’ relationship by removing any doubt as to what law applies. Second, they foster uniformity among dealers in various states by assisting in the imposition of similar obligations on the part of both the manufacturer and the dealers, regardless of the location of the dealerships. Third, by permitting the manufacturer to select the law of a state with which it is familiar, these provisions tend to effectuate the policy in favor of upholding contracts by preventing frustration of the parties’ expectations by unknown or unforeseen legal doctrines from one state or another. A manufacturer trying to maintain uniform standards and communicate uniform expectations to its dealers scattered in many states can do so only if it is confident of the application of the law of a single state to its relations with its dealer network.

Generally, the choice of law by the parties to a contract will be upheld so long as there is a reasonable or substantial relationship of that state to the parties or to the contract or transaction at issue and there is no violation of a fundamental policy of a state with a greater interest in the determination of the particular issue than the chosen state. However, in terminated dealer cases, the courts have also held that they need not address or enforce choice of law provisions if the laws of the two states in issue are substantially the same.

The courts of most states respect choice of law provisions, even when the law

60. Id. at 647–48.
61. Id. at 648.
62. A typical provision of this sort reads: “This agreement shall be construed according to and the legal relations between the parties governed by the laws of the state of New York.”
64. Camfield Tires v. Michelin Tire Corp., 719 F.2d 1361, 1366 n.2 (8th Cir. 1983); New Linen Supply v. Eastern Env'tl. Controls, 96 Cal. App. 3d 810, 817 n.2, 158 Cal. Rptr. 251, 255 n.2 (1979) (reversing the denial of a petition to compel arbitration in a distributor’s action against the manufacturer); Berman v. Dean Witter & Co., 44 Cal. App. 3d 999, 1003, 119 Cal. Rptr. 130, 133 (1975) (“Although the contract contains a provision that its enforcement shall be governed by New York law . . . it appears that whichever law is applied the result is the same since in all material aspects the law of both jurisdictions is the same.”). Gainer v. DuPont Glove Forgan, Inc., 65 Cal. App. 3d 280, 286–87, 135 Cal. Rptr. 230, 233 (1976), also held that a choice of forum provision is “a more drastic thing than a choice of law provision,” although both are usually respected by California courts. The court also stated: “The choice of law provision is not invalid as a matter of law, because contained in a contract of adhesion.” Id. at 287, 135 Cal. Rptr. at 233. See also Coastal Steel v. Tligman Wheelabrator Ltd., 709 F.2d 190, 202 (3d Cir.) (a choice of law provision “need not be resolved in this case either, for each jurisdiction whose law is arguably relevant takes substantially the same position with respect to enforceability of contractual forum selection provisions.”), cert. denied, 464 U.S. 938 (1983); Bes Material Handling v. Crown Controls Corp., 137 Cal. App. 3d 99, 105, 186 Cal. Rptr. 740, 742 (1982) (case handled by the author; “the dealer agreement contains a provision that its construction shall be governed by Ohio law. However, it is unnecessary to address choice of law problems at this juncture since the result as to arbitrability would be the same in either jurisdiction.”).
chosen is that of another country. The Sixth Circuit has held that a choice of law provision designating Wisconsin law made applicable the substantive laws of that state, including the Wisconsin Fair Dealership Law, a strict dealer protection statute. In so holding, the court rejected the manufacturer’s argument that the effect of the choice of law provision was only to give meaning and effect to the language of the agreement, rather than to be “governed” by the laws of the state of Wisconsin. In another case, the Eighth Circuit, upholding a trial court’s refusal to apply California substantive law on restrictive covenants in employment contracts, held that California’s law did not control because the agreement contained an express choice of Minnesota law. These results are in accord with the modern trend of authority.

E. Forum Selection Clauses

It is a common practice to include in distributorship agreements a forum selection clause providing that the courts of a particular country or state shall be the forum for resolution of disputes between the parties. It is important that the forum selection clause be contained in the distributorship agreement and not in a related or ancillary agreement if it is intended that the forum selection clause should govern disputes arising under the dealer agreement. This section of the Article reviews the major
cases regarding forum selection clauses, and notes the particular problems they create in distribution agreements.

Two opinions of the United States Supreme Court have sanctioned the use of forum selection clauses. The Bremen v. Zapata Off-Shore Co.,75 held that a forum selection clause in a maritime towage contract between an American plaintiff and a German defendant was valid and enforceable. The Supreme Court stated that public policy favors the enforcement of such provisions and that such clauses are prima facie valid and should be enforced unless the resisting party shows that enforcement would be unreasonable and unjust, or that the clause is invalid as a result of fraud or overreaching.76 The other leading Supreme Court case is Scherk v. Alberto-Culver Co.,77 which recognized the general acceptability of a forum selection provision. Certainly these provisions must be acceptable when inserted into a manufacturer's transactions with its nationwide network of dealers. Further, it is well settled that parties to an agreement may agree to submit to the jurisdiction of a particular court for the resolution of controversies arising out of their contract, and may also agree as to the manner and method of notice.78 The interests promoted by such an arrangement include the prevention of frivolous litigation instituted by a dealer, the selection of a court more familiar with the law that is to be applied to the construction and interpretation of the dealer agreement, and uniformity in the enforcement and construction of the standard distributorship agreements.

In fact, the courts have upheld the enforcement of forum selection provisions in dealer agreements. For example, Bense v. Interstate Battery System of America,79 affirmed the dismissal of a complaint for lack of proper venue in an action for damages for violations of the antitrust laws. The plaintiff was a distributor for the state of Vermont and certain portions of the state of New York; the defendant manufacturer was located in Texas. The terminated agreement provided that any action arising from the agreement could be brought only in Dallas County, Texas.80 The Second Circuit held that the forum selection clause would be enforced under the principles of Bremen and Scherk, and rejected the plaintiff's argument that a choice of law provision in the agreement required the selection of Texas law, and that Texas venue law (which disfavored forum selection clauses) was therefore applicable.81 Similarly, the Ninth Circuit in Crown Beverage Co. v. Cerveceria Moctezuma, S.A.,82 dismissed a

75. 407 U.S. 1 (1972).
76. Id. at 9–12. Accord Bryant Elec. Co. v. City of Fredricksburg, 762 F.2d 1192, 1196–97 (4th Cir. 1985) (upholding forum selection provision; Virginia law applied); Pelleport Investors v. Budco Quality Theatres, 741 F.2d 273, 279 (9th Cir. 1984); Mercury Coal & Coke v. Mannesmann Pipe & Steel Corp., 696 F.2d 315, 317–18 (4th Cir. 1982) (following Bremen; recognizing that both West Virginia and New York enforce forum selection clauses; reversing the grant of an injunction against New York litigation of a claim for damages for breach of a contract for the purchase of coal).
79. 683 F.2d 718 (2d Cir. 1982).
80. Id. at 719–20.
81. Id. at 721–22.
plaintiff dealer’s pendent contract claim on the ground that a forum selection clause which chose Mexican courts was enforceable.

A useful case in the terminated dealer area is Garay v. Scott & Fetzer Co., in which the plaintiff vacuum cleaner distributor attempted to avoid a forum selection clause in his written distributor agreement by arguing that the defendant’s alleged anticompetitive torts and alleged violations of the Maryland Antitrust Act were not within that provision. The court transferred the action in accordance with the choice of forum provision, which stated that the plaintiff must bring “any legal action against The Company arising out of or related in any manner to this Distributor Agreement or to the relationship and/or dealings between distributor and The Company” solely in the United States District Court for the Northern District of Ohio or the Court of Common Pleas for Cuyahoga County, Ohio.

The California Supreme Court has upheld a forum selection clause that required any action arising out of an insurance agency agreement to be brought in Philadelphia. In Smith, Valentino & Smith, Inc. v. Superior Court of Los Angeles County, the court rejected the plaintiff’s argument that because it had asserted claims couched in tort terms, the tort counts did not arise under a forum selection paragraph that required litigation in Pennsylvania of any actions “with respect to any matters arising under or growing out of this agreement.” The court held that forum selection clauses are valid and may be given effect in the absence of a showing that enforcement of such a provision is unreasonable. The opinion in Smith, Valentino & Smith is a useful opinion with respect to a dealer agreement, because the insurance agency agreement involved is in essence the same type of commercial contract as a distributorship agreement.

Other courts do not look with the same favor upon forum selection clauses. The Tenth Circuit has held that the applicability of such a provision is itself an issue of fact, and that it is not “vexatious for a party to raise this issue in a forum other than the one designated in the venue selection clause.” In Cutter v. Scott & Fetzer Co., a Wisconsin distributor succeeded in evading a forum selection clause because the Wisconsin Fair Dealership Law supported the plaintiff’s argument that public policy favored the right to maintain the litigation in Wisconsin.

for amounts owed for services under a contract, and for quantum meruit, but denying enforcement for cross claim over which the court exercised ancillary jurisdiction because it was inextricably intertwined with issues presented in complaint). 83. 1981-1 Trade Cas. (CCH) ¶ 64,051 (D. Md. 1979). 84. Id. 85. 17 Cal. 3d 491, 551 P.2d 1206, 131 Cal. Rptr. 374 (1976). 86. The plaintiff claimed breach of contract, intentional interference with advantageous business relationships, and unfair competition. Id. at 494, 551 P.2d at 1209, 131 Cal. Rptr. at 376. 87. Id. at 497, 551 P.2d at 1210, 131 Cal. Rptr. at 378. 88. Id. at 496, 551 P.2d at 1209, 131 Cal. Rptr. at 377. 89. See, e.g., Colonial Leasing Co. v. Pugh Bros. Garage, 735 F.2d 380, 382 (9th Cir. 1984) (under Oregon law, a fine print take-it-or-leave-it forum selection clause in leasing contract given no effect). Kolendo v. Jerrell, Inc., 1980-81 Trade Cas. (CCH) ¶ 63,831 (S.D.W. Va. 1980) denied enforcement of a forum selection clause in a contract between the plaintiff and his former employer. The court correctly described the effect of forum selection provisions as “pre-litigation waivers of venue,” id., but used reasoning applicable to many cases to deny enforcement of such a provision. 90. Hospah Coal Co. v. Chaco Energy Co., 1982-1 Trade Cas. (CCH) ¶ 64,635 (10th Cir. 1982). 91. 510 F. Supp. 903 (E.D. Wis. 1981). 92. Id. at 908. The court noted that the same forum selection clause was enforced in a Maryland case, Garay v.
The general rule is that "the question of the enforcement of forum selection clauses is to be decided under federal law."93 However, there is a split among the cases as to whether the enforceability of contractual forum selection clauses should be determined under federal law or state law.94

The interaction between a forum selection clause and the two federal change of venue statutes, 28 U.S.C. §§ 1404(a) and 1406(a), presents another issue. A number of cases have used these venue statutes to transfer a case in accordance with a forum selection clause;95 section 1404(a) may also be used to transfer a case to a district other than the one chosen under a forum selection clause. "Although forum-selection clauses are usually upheld absent a showing of unreasonableness, the existence of such a clause, if not mandatory, does not prevent the court from ordering a change of venue under section 1404(a)."96 Finally, "[c]onsideration of the criteria relevant to a motion under section 1404(a) is an accepted procedure when evaluating a forum-selection clause."97

In cases in which the manufacturer does not wish to use arbitration as the method of resolving disputes arising under the distributorship agreement, a well-drafted forum selection provision is appropriate, and should be given effect. Following the lead of the Supreme Court, the federal and state courts are increasingly willing to enforce such provisions.98

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93. C. Pappas Co. v. E. & J. Gallo Winery, 565 F. Supp. 1015, 1016 (D. Mass. 1983) (claims by a Massachusetts wine distributor against its California suppliers were to be resolved in the California courts, under a forum selection clause in the distributorship agreement; plaintiff's claims included violations of the federal antitrust laws and state law claims for breach of contract, breach of fiduciary duties, tortious interference with prospective business relations, and violation of the Massachusetts Consumer Protection Act).

94. Coastal Steel Corp. v. Tilghman Wheelabrator Ltd., 709 F.2d 190 (3d Cir. 1983) collected the cases that discussed this split of authority, but held that the court need not resolve the question, "for each jurisdiction whose law is arguably relevant takes substantially the same position with respect to enforceability of contractual forum selection provision." Id. at 202. See generally Note, Incorporation of State Law Under the Federal Arbitration Act, 78 Minn. L. Rev. 1391 (1980).


96. Credit Alliance Corp. v. Crook, 557 F. Supp. 1462, 1464 (S.D.N.Y. 1983) (citation omitted). That opinion held that a forum selection provision is not a waiver of a party's right to seek a transfer to another district for its own convenience under section 1404(a) unless "that party's preselected forum is one that by the terms of the agreement 'is assigned exclusive jurisdiction of cases arising under the contract.'" Id. at 1465, quoting Plum Tree, Inc. v. Stockment, 488 F.2d 754, 758 n.7 (3d Cir. 1973). Credit Alliance contains an important lesson in drafting forum selection provisions; it distinguishes between language that empowers state courts to adjudicate a matter, and language that provides that a state is the exclusive or the only appropriate forum where the case may be heard. 557 F. Supp. at 1465.


98. Bense v. Interstate Battery Sys. of Am., 683 F.2d 718, 721–22 (2d Cir. 1982) (terminated distributor's antitrust claims held properly dismissed for lack of venue because forum selection agreement provided that exclusive venue was to be Dallas County, Texas).
F. Arbitration Agreements

Many distributorship agreements contain arbitration provisions. This discussion of arbitration agreements follows the analysis of forum selection clauses because, as the Supreme Court recognized in Scherk v. Alberto-Culver Co.,\(^9\) an arbitration provision "is, in effect, a specialized kind of forum-selection clause that posits not only the situs of the suit but also the procedure to be used in resolving the dispute."\(^10\)

The benefits of an arbitration agreement\(^11\) in a distributorship contract are that the process is speedy, there is no trial by jury, the parties may specify the venue of the arbitration as well as the type and size of panel that is to hear the case, and the arbitration is a cheaper and more private proceeding than a court action.\(^12\)

A common mistake made by the terminated dealer plaintiff is to ignore an arbitration agreement and then resist the defendant manufacturer's attempt to compel arbitration by raising thin arguments to defeat arbitration, instead of demanding a speedy arbitration and perhaps contesting only the location of the arbitration. A challenge to the venue of the arbitration may be raised either under the rules of the American Arbitration Association\(^13\) or under various principles governing contracts of adhesion.\(^14\)

Under both state and federal law, there are strong policies favoring arbitration. The federal policy derives from the United States Arbitration Act,\(^15\) which the United States Supreme Court has recognized as embodying a "statutory policy of rapid and unobstructed enforcement of arbitration agreements."\(^16\) The federal policy regarding arbitration also includes a policy that "requires a liberal reading of arbitration agreements,"\(^17\) and a rule that "as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself of an allegation of

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\(^{10}\) Id. at 519.

\(^11\) A typical arbitration provision is the standard broad form clause of the American Arbitration Association. Some arbitration agreements also specify the number of arbitrators, the method of selecting the arbitrator or the panel, and various other instructions concerning the consideration of the issues or the decision to be rendered.

\(^12\) Courts have expressed skepticism about the lengths to which parties sometimes go to delay arbitration, thereby robbing the procedure of its advantages. Although arbitration "is often thought of as a quick and efficient method" to resolve disputes, "cases involving arbitration clauses sometimes are best remembered as monuments to delay because of the litigation and appeals antecedent to the actual arbitration." Ohio-Sealy Mattress Mfg. Co. v. Duncan, 712 F.2d 270 (7th Cir. 1983) (quoting Standard Chlorine, Inc. v. Leonard, 384 F.2d 304, 305 (2d Cir. 1967)). Accord Merit Ins. Co. v. Leatherby Ins. Co., 714 F.2d 673, 683 (7th Cir.) (condemning "an interminable chapter in the efforts of people who have chosen arbitration and been disappointed in their choice to get to the courts—to which they could have turned in the first instance for resolution of their disputes—to undo the results of their preferred method of dispute resolution"), cert. denied, 464 U.S. 1009 (1983).

\(^13\) American Arbitration Ass'n Commercial Arbitration Rule 11.

\(^14\) A case handled by the author, Bos Material Handling v. Crown Controls Corp., 137 Cal. App. 3d 99, 108, 186 Cal. Rptr. 740, 744 (1982), held "as a matter of law that the contractual provision requiring arbitration is neither contrary to the reasonable expectations of Bos nor so unfair as to be unconscionable." The Court of Appeal then held that the plaintiff dealer was entitled on remand "to an evidentiary hearing on whether the dealer agreement is adhesive and, if so, whether the Ohio forum comports with the reasonable expectations of Bos or is unduly oppressive." Id.


\(^17\) Id. at 23 n.27. Accord In re the Arbitration between Sharp Elecs. Corp. v. Branded Prods., 1984-2 Trade Cas. (CCH) ¶ 66,314 (S.D.N.Y. 1984) (state antitrust action was within terms of broad arbitration clause; federal policy favoring arbitration preempted any state antitrust policy or law).
waiver, delay, or a like defense to arbitrability." Further, court litigation over arbitrability of issues is discouraged. "Contracts to arbitrate are not to be avoided by allowing one party to ignore the contract and resort to the courts. Such a course could lead to prolonged litigation, one of the very risks the parties, by contracting for arbitration, sought to eliminate." 

The leading cases stating the federal policy in favor of arbitration are the *Steelworkers Trilogy*. One of the principles enunciated in the *Steelworkers Trilogy* is that arbitration "should not be denied unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute. Doubts should be resolved in favor of coverage." The *Steelworkers Trilogy* has been adopted by many states as part of their substantive law. In *Cincinnati Gas & Electric Co. v. Benjamin F. Shaw Co.*, the Sixth Circuit, after quoting from the *Steelworkers Trilogy*, recently explained that

[lower federal courts have applied these principles to cases arising out of commercial transactions as well as those related to labor disputes. Where a commercial contract contains a broad arbitration provision covering all controversies arising under the agreement, arbitration is ordered unless the parties seeking to avoid it can show that the particular dispute is expressly excluded.]

States which have announced strong public policies in favor of arbitration as a means of settling disputes include California, Ohio, and New York. Given the strong public policies in favor of arbitration and the utility of arbitration as a device to resolve dealer disputes, the presence of a broad arbitration provision in a dealer
agreement coupled with discovery should establish that a terminated dealer's causes of action are arbitrable.

In this regard, there are two lines of cases which are relevant. First, there are those cases in which the claims of terminated dealers have been held arbitrable. The leading case is *Becker Autoradio U.S.A. v. Becker Audoradiowerk GmbH,*[119] in which the Third Circuit reversed the denial of a motion to compel arbitration in an action by an exclusive distributor against a West German automobile radio manufacturer. The plaintiff sought damages for the defendants' failure to renew its exclusive distributorship agreement. The defendant manufacturer sought arbitration under a written arbitration provision of the distribution agreement that provided for arbitration in Germany of "all disputes arising out of and about this agreement."[120]

The trial court rejected the defendants' argument that the dispute was one "arising out of" the agreement, and held that the dispute between the parties arose out of a separate and distinct oral agreement that the manufacturer would renew the distributorship agreement if the plaintiff fulfilled certain conditions such as opening a branch office, establishing some exhibits at its expense, and performing without compensation certain administrative functions.[121]

The Court of Appeals reversed the order denying arbitration, using reasoning that would be applicable to most disputes over arbitrability of claims between a terminated dealer or franchisee and a defendant manufacturer. Emphasizing the strong policy in favor of arbitration, the court stated that the arbitration provision would be liberally construed, and that any doubts would be resolved in favor of arbitration.[122] The court then held that the controversy concerning whether the defendant manufacturer "agreed to extend the 1974 Agreement beyond its 1976 expiration date"[123] was one which arose out of the contract because the subject of termination and renewal was covered by the contract itself.[124]

Since most dealer agreements cover the subjects of termination and renewal, a broad arbitration provision should require arbitration of disputes over the causes, validity, or circumstances of termination or nonrenewal.[125] Phrased another way, the test under a broad form arbitration provision is whether the issues presented in the plaintiff's complaint arose from the relationship between the plaintiff and defendant.[126]

A second case of broad applicability is *Bos Material Handling v. Crown Controls Corp.*, which reversed the denial of a petition to compel arbitration under

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[120] Id. at 42.
[121] Id.
[123] Id. at 45.
[124] Id.
[125] Id. at 46.
a broad arbitration provision in a dealer agreement. The case is useful because it dealt with causes of action that frequently appear in dealer litigation. The plaintiff’s causes of action, each of which complained of the unilateral termination of the dealer agreement, consisted of tortious breach of duty of good faith and fair dealing, interference with economic relations, fraud, unfair competition, restraint of trade under California’s antitrust statute, and intentional interference with prospective advantage and contract.\textsuperscript{128} The court held that all causes of action except the state antitrust claim were arbitrable because the agreement “has specific provisions relating to extension and termination.”\textsuperscript{129} However, the court found that under California law the selection of Ohio as the forum for arbitration could be an invalid provision of the agreement, and remanded for an evidentiary hearing on that issue.\textsuperscript{130}

As with claims under the Sherman Act, the court held that the state antitrust claim was not arbitrable,\textsuperscript{131} but must be stayed pending arbitration of the other controversies arising out of or relating to the dealer agreement.\textsuperscript{132}

Numerous other cases have dealt with claims by terminated dealers, and have held them to be arbitrable. Cases from the First Circuit,\textsuperscript{133} the Second Circuit,\textsuperscript{134} and numerous federal district court\textsuperscript{135} and state court opinions\textsuperscript{136} have held that claims by terminated dealers or claims under exclusive sales contracts are arbitrable.

A second line of cases that is helpful in arguing for arbitration of a terminated dealer’s claims are cases, which through broad construction, fully enforce arbitration

\textsuperscript{128} Id. at 104, 186 Cal. Rptr. at 742.
\textsuperscript{129} Id. at 106, 186 Cal. Rptr. at 743.
\textsuperscript{130} Id. at 108, 186 Cal. Rptr. at 744.
\textsuperscript{131} Id. at 109–11, 186 Cal. Rptr. at 745–46.
\textsuperscript{132} Id. at 111, 186 Cal. Rptr. at 747. Accord NPS Communications v. Continental Group, Inc., 1984–2 Trade Cas. (CCH) ¶ 66,297 (S.D.N.Y. 1984) (where antitrust claim was severable or its validity unclear, federal antitrust claim was stayed pending arbitration).
\textsuperscript{133} Hilti, Inc. v. Oldach, 392 F.2d 368 (1st Cir. 1968) (requiring arbitration of claims by a terminated sales representative that defendant had terminated the franchise and dealership without proper and just cause; court rejected the plaintiff’s argument that its claim (based upon a recently enacted Puerto Rican dealer protection statute) was outside the scope of the arbitration provision, and held that the broad language of the arbitration agreement required the conclusion “that the parties intended to arbitrate all disputes arising thereunder irrespective of whether they were foreseeable at the time of agreement.” “Id. at 372–73.”)
\textsuperscript{134} Roso-Lino Beverage Distribs. v. Coca-Cola Bottling Co., 749 F.2d 124 (2d Cir. 1984); Necchi Sewing Mach. Sales Corp. v. Necchi, S.P.A., 369 F.2d 579, 582 (2d Cir. 1966) (claims for unfair competition, unauthorized trademark use and abandonment of distributorship agreement held to be within an arbitration provision as “arising out of or in connection with” id).
\textsuperscript{135} Else v. Inflight Cinema Int’l, 465 F. Supp. 1239, 1243 (W.D. Pa. 1979) (ordering arbitration of claims for violation of California Franchise Investment Law and fraudulent misrepresentation where distributor agreement provided for arbitration of “any dispute or controversy arising hereunder’’); Kastanias v. Nationwide Auto Transporters, 390 F. Supp. 720, 722 (W.D. Pa. 1975) (cause of action for ‘‘unjust termination’’ of agency agreement that was renewable from year to year held to be arbitrable under the ‘‘broad language’’ of that provision); Zenol, Inc. v. Carblox, Ltd., 334 F. Supp. 866, 869 (W.D. Pa. 1971) (claim for damages for wrongful termination of exclusive sales agency contract is within the scope of arbitration clause), aff’d, 474 F.2d 1338 (3d Cir. 1973); Sumaza v. Cooperative Ass’n, 297 F. Supp. 345, 348–49 (D.P.R. 1969) (granting a motion to stay proceedings pending arbitration in an action by terminated agent under written distributorship contract for sale of meat products; dispute was based upon Puerto Rican Dealers Act).
agreements,\textsuperscript{137} or hold that arbitration provisions with broad language include tort claims. As Judge Learned Hand wrote fifty years ago: "If the clause is general in form, it makes no difference what may come up under it."\textsuperscript{138} Both state\textsuperscript{139} and federal opinions\textsuperscript{140} have held that broad form arbitration provisions include tort claims as well as contract claims.

In summary, the argument in favor of arbitration should be constructed as follows:

1. There is a strong public policy in favor of enforcing written arbitration agreements in the jurisdiction involved;

2. The governing principal is that arbitration should be compelled unless it can be said with positive assurance that the arbitration provision is not susceptible to an interpretation that covers the asserted dispute.\textsuperscript{141}

3. The arbitration provision in the agreement contains broad language of the type that has been held to include the plaintiff's claims;

4. The testimony on deposition or at hearing established that the claims underlying the complaint are within the arbitration provision;

5. The case law has held that similar claims by terminated distributors are arbitrable.

G. Limitations and Exclusions of Damages

Many distributorship contracts contain provisions that seek to limit liability for damages, or to exclude recovery of certain types of damages upon termination of the agreement. Perhaps the leading case is Stanley A. Klopp, Inc. v. John Deere Co.,\textsuperscript{142} in which the trial court held that a clause disclaiming liability for lost profits or other losses precluded the recovery of lost profits as damages for an alleged wrongful termination.\textsuperscript{143} The court held that as a matter of law this provision was not unconscionable.\textsuperscript{144} The court further rejected the plaintiff's argument that the limitation clause did not apply in the case of wrongful termination.\textsuperscript{145}

In Phillips Machinery Co. v. LeBlond, Inc.\textsuperscript{146} a provision of a machine tool

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\item 137. See Guinness-Harp Corp. v. Jos. Schlitz Brewing Co., 613 F.2d 468, 470–71 (2d Cir. 1980) (an agreement that a distributor would not be terminated unless disputes were submitted to arbitration, was enforceable by preliminary injunction).
\item 139. Berman v. Dean Witter & Co., 44 Cal. App. 3d 999, 1004–06, 119 Cal. Rptr. 130, 133–34 (1975) (reversing denial of petition to compel arbitration and to stay proceeding, requiring arbitration of tort claims of negligence and breach of a fiduciary relationship); Lewsadder v. Mitchum, Jones & Templeton, Inc., 36 Cal. App. 3d 255, 111 Cal. Rptr. 405 (1973) (reversing the denial of a petition to compel arbitration and to stay an action for intentional torts (fraud and libel) under an "any controversy" arbitration agreement).
\item 140. Blumberg v. Berland, 678 F.2d 1068, 1070–71 (11th Cir. 1982) claims of breach of fiduciary duty, deceit, negligence, and breach of contract held arbitrable in New York under an "any controversy" arbitration provision; In re Oil Spill by Amoco Cadiz, 659 F.2d 789, 794 (7th Cir. 1981).
\item 141. See the Steelworkers Trilogy discussed at notes 110–14, supra.
\item 143. Id. at 809.
\item 144. Id. at 810–11.
\item 145. Id. at 811–12.
\item 146. 494 F. Supp. 318, 323–24 (N.D. Okla. 1980). See also Cowin Equip. Co. v. General Motors Corp., 734 F.2d
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distribution agreement that excluded damages for lost profits resulting from cancel-
lation was held not to be unconscionable under Oklahoma law. Similarly, in Zunch
v. Artec International Corp.,\textsuperscript{147} the court held enforceable under California law a
provision which stated that upon termination, the defendant was not liable for
damages or for commissions, expenditures, investments or opportunities foregone.
As in Stanley A. Klopp, Inc., the court rejected a claim that this provision did not
apply to a cause of action for unlawful termination.\textsuperscript{148}

A less restrictive provision was upheld in RJM Sales & Marketing v. Banfi
Products Corp.\textsuperscript{149} The provision limited liability to the distributor in the event
to commissions on orders shipped within ninety days of the effective date
of termination.\textsuperscript{150} A provision which gives some remedy to the dealer rather than a
“no damages” provision, will be more readily upheld by the courts. “Similar
limitation of liability clauses between commercial parties have been held enforceable
repeatedly.”\textsuperscript{151}

H. Provisions for Repurchase of Dealer Inventory

A number of courts have upheld provisions regarding the repurchase of products
by the manufacturer from the distributor upon termination of the distributorship
agreement. In W.L. May Co. v. Philco-Ford Corp.,\textsuperscript{152} the Supreme Court of Oregon
rejected the dealer’s claim that a provision in the distributorship contract giving the
manufacturer the option to repurchase any of its products sold to the distributor, was
unconscionable at the time of the formation of the contract, and that the manufac-
turer’s refusal to repurchase the inventory rendered the termination provisions
unconscionable.\textsuperscript{153} Kirby v. Chrysler Corp.\textsuperscript{154} held that an obligation to repurchase
a former automobile dealer’s inventory of new vehicles was enforceable and that the
plaintiff was entitled to damages in storage charges and finance charges caused by the
defendant’s failure to repurchase the vehicles within ninety days of the effective date
of termination of the dealer agreements.

Finally, Walnut Creek Pipe Distributors v. Gates Rubber Co. Sales Division,\textsuperscript{155}
held that no implied covenant to repurchase would be found in a jobber distributor
contract, reasoning that courts will not rewrite harsh or inequitable contracts and that
contract terms will not be implied unless necessary.

\textsuperscript{151}Id. at 1375-76.
\textsuperscript{150}Id. at 1368 (D. Minn. 1982).
\textsuperscript{149}546 F. Supp. 1368 (D. Minn. 1982).
\textsuperscript{148}Id. at 968-69.
\textsuperscript{147}559 F. Supp. 961, 968 (S.D.N.Y. 1983).
\textsuperscript{154}554 F. Supp. 743, 756-57 (D. Md. 1982); see also Motive Parts Warehouse v. Facet Enters., 774 F.2d 389
(10th Cir. 1985).
\textsuperscript{155}228 Cal. App. 2d 810, 815, 39 Cal. Rptr. 767, 771 (1964).
I. The Integration or Merger Clause

The integration or merger provision is one of the most common and most ignored sections of a distributorship agreement. It is also one of the provisions that is potentially most useful to the manufacturer faced with a suit by one of its former dealers. For example, in rejecting the plaintiff's argument that the district court erred in finding that there existed a nonexclusive licensing agreement as a matter of law, the Fifth Circuit held that the merger provision was determinative. The Fifth Circuit stated the classic reasoning concerning the enforcement of a merger provision: "[I]t makes clear the intention of both parties that the agreement was to be the complete and exclusive statement of terms so as to preclude the consideration of any evidence as to consistent additional terms under U.C.C. 2–202(b)." Similarly, in affirming the entry of summary judgment for a defendant in an action brought by franchisees of retail panelling stores against a general distributor, the Court of Appeals for the District of Columbia Circuit relied on a merger clause to agree with the district court that the franchise agreements were not ambiguous. In addition, the court held that the integration clause and the parol evidence rule together showed that the district court properly refused to consider minutes of a management meeting of the franchisor, because the "franchise contracts state unequivocally that they embody the final and exclusive understanding of the parties, and District law gives full effect to that stipulation."

A similar analysis was employed by the Ninth Circuit in Golden Gate Acceptance Corp. v. General Motors Corp. There, the court affirmed a grant of summary judgment in an action by an automobile dealer, in which the plaintiff dealer attempted to raise an issue of material fact by arguing about the dealer's understanding of the terms of the agreement, and that an employee of the manufacturer had made certain statements prior to execution of the agreement. However, the Ninth Circuit rejected both those arguments and the attempt to create a genuine issue of material fact. Accordingly, if the dealer agreement contains an integration clause, attempts by a plaintiff dealer to avoid the unambiguous language in a dealer agreement should be rejected.

In many terminated dealer cases, the sequence of the arguments of the parties follows a similar pattern. First, the dealer argues that some conduct of the manufacturer constituted a "bad faith" or "wrongful" termination. The manufacturer then responds by pointing to the language in the dealer agreement that justifies the conduct taken by the manufacturer. Next, the dealer replies that representatives of the

156. A provision of this type is customarily found in business contracts.
158. Id. at 149.
160. Id. at 1281 (footnotes omitted).
161. 597 F.2d 676 (9th Cir. 1979).
162. Id. at 680-81.
163. Id. at 680.
164. This language may include provisions requiring the dealer to take certain steps on pain of termination, or provisions permitting termination upon the occurrence of specified events.
manufacturer orally agreed to the dealer’s actions, or waived certain requirements of the dealer agreement. It is these very claims that an integration clause can successfully refute, without the necessity for a trial.

Nevertheless, it is possible to avoid the effect of integration clauses if the course of dealings between the parties was extremely informal, or if there was fraudulent conduct. For example, the Sixth Circuit has held that a written franchise contract was not completely integrated even though it contained a merger clause. In that case a franchised dealer for motor homes claimed that there was an agreement that the dealer could return unsold units to the manufacturer for full credit. The district court’s holding that the parol evidence rule barred evidence of the alleged repurchase agreement was reversed. The court of appeals observed that the parties had conducted their transaction very informally and therefore, even though the written dealer agreement contained an integration provision, oral evidence of the supposed repurchase agreement should have been admitted.

The rationale for rejecting an integration clause as a result of fraud was well stated by the Virginia Supreme Court in Packard Norfolk, Inc. v. Miller, in which the court held that fraud in the inducement of a contract rendered the entire contract voidable. The court specifically applied this reasoning to an integration clause. The same court also had held that even though a franchise contract disclaimed the existence of a principal-agent relationship between a franchisor and its franchisee, an agency relationship may still arise. Therefore, an integration clause must be distinguished from a disclaimer; an integration provision serves to reject alleged inconsistent agreements, but by its own terms does not operate as a definitive limitation upon the parties’ relationship.

III. The Second Step: The Bodies of Substantive Law Applicable to Claimed Violations of Dealership Agreements or Other Wrongful Conduct by Manufacturers

A variety of state and federal substantive laws may apply to dealer-manufacturer disputes. State statutes include the Uniform Commercial Code, various dealer protection acts, the “baby Sherman Acts” enacted by most states, and in some instances, state franchise or deceptive trade practices statutes. In addition to this

166. Id. at 1111.
167. Quoted in full, id. at 1110.
168. 198 Va. 557, 564, 95 S.E.2d 207, 212 (1956).
169. Id. at 565, 95 S.E.2d at 213 (quoting other authority).
171. Wisconsin has the most restrictive state dealer protection act. See infra text accompanying notes 362–80.
172. See infra note 180.
173. For example, in 1980 California enacted the California Franchise Relations Act, CAL. BUS. & PROF. CODE §§ 20000–20043 (West Supp. 1985). Among other provisions, the statute imposes good cause and notice requirements for termination; section 20020 provides that there may be no termination before expiration of the term of an agreement except for good cause. Other provisions restrict the ability to fail to renew a franchise (section 20025, requiring “at least 180 days prior written notice of its intention not to renew” as well as precluding enforcement of any covenant of the nonrenewed franchisee not to compete with the franchisor or other franchisees), and require repurchase of resalable
state legislation, the state common law of contracts and torts, as well as procedural actions, such as preliminary injunctions, must be considered. However, the discussion of state law in this Article focuses on the Uniform Commercial Code because it is the law under which many dealer disputes are litigated. Significant applicable federal laws include the antitrust laws, the Petroleum Marketing Practices Act, and the Franchise Act.
the Dealers' Day in Court Act,178 and the United States Arbitration Act.179

A. The Antitrust Laws

1. Introduction

Under federal or state180 antitrust laws, a terminated dealer has an uphill struggle...
in gaining relief. The United States Supreme Court decisions in *Continental T.V. v. GTE Sylvania, Inc.* and *Monsanto Co. v. Spray-Rite Service Corp.* have made it very difficult for a terminated dealer to obtain relief under the antitrust laws. This section of the Article assumes familiarity with the federal antitrust laws and with

apply in construing the Cartwright Act." *Derish v. San Mateo-Burlingame Bd. of Realtors*, 724 F.2d 1347, 1350 (9th Cir. 1983) (collecting cases). *Accord Standard Liquor Corp. v. Olympia Brewing Co.*, 1983–1 Trade Cas. (CCH) ¶ 65,230 (D. Kan. 1982) (under *Antitrust Act*, temporary restraining order prohibiting beer brewer from terminating distributor was allowed to expire because of lack of irreparable harm and because mere substitution of dealers is not an antitrust violation); *Bos Material Handling v. Crown Controls Corp.*, 137 Cal. App. 3d 99, 109, 186 Cal. Rptr. 740, 745 (1982); *Gould Wineries & Distilleries v. J. Sonnick & Son*, 102 Cal. App. 3d 627, 162 Cal. Rptr. 87 (1980) (illegality under *Cartwright Act* of termination of distributor); *St. Petersburg Yacht Charters v. Morgan Yacht*, 457 So. 2d 1028 (Fla. Dist. Ct. 1984) (terminated yacht dealer stated cause of action against sailboat manufacturer under Florida Antitrust Act, but rule of reason applicable and no per se violations stated, under motion for summary judgment in action under Donnelly Act; applying federal precedent); *List v. Burley Tobacco Growers’ Coop. Ass’n*, 114 Ohio St. 361, 369, 151 N.E. 471, 474 (1926). See also *Zimmerman v. Board of Publications*, 1985–1 Trade Cas. (CCH) ¶ 66,501 (D. Colo. 1985); *Westbury Donuts v. Dunkin’ Donuts of Am.*, 1982–2 Trade Cas. (CCH) ¶ 64,951 (E.D.N.Y. 1982) (after holding that a conspiracy to terminate one franchisee and substitute another was not a Sherman Act violation, the court held the same analysis applicable under the state antitrust law); *State v. Carvel Corp.*, 1984–1 Trade Cas. (CCH) ¶ 65,926 (N.Y. Sup. Ct. 1984) (granting defendant’s motion for summary judgment in action under Donnelly Act; applying federal decisions in holding that a contract between an ice cream franchisor and an ice cream mix producer was not an illegal tying arrangement); *Troop v. Central Inv. Corp.*, 11 Ohio Bar Rpt. 567 (Ashland County C.P. 1983).


Further, the close relationship of the federal and state antitrust acts is demonstrated by the rule that facts determined in one such antitrust action are given collateral estoppel effect in the other action. University Life Ins. Co. of Am. v. Unimue Ltd., 699 F.2d 846 (7th Cir. 1983). Not only collateral estoppel but also res judicata will prevent a plaintiff losing under one Act from bringing the same suit against the same defendant under the other Act. After extensive analysis, the court in *Derish v. San Mateo-Burlingame Bd. of Realtors*, 724 F.2d 1347 (9th Cir. 1983) concluded that "res judicata must bar a plaintiff who loses under the *Cartwright Act* from bringing the same suit against the same defendant in federal court under substantially the same law in the *Sherman Act*. When both state and federal law offer a plaintiff equally sharp teeth for enforcing the same claim, he may indeed have but ‘one bite at the apple.’" *Id.* at 1352. *Accord Daley v. Town of New Durham*, 733 F.2d 4 (1st Cir. 1984) (antitrust action dismissed; federal district court acquires no jurisdiction over a claim under the Sherman Act that was removed to district court from state court because state court lacked subject matter jurisdiction; federal courts have exclusive jurisdiction over antitrust claims); Salveson v. Western States Bankcard Ass’n, 731 F.2d 1423, 1431 (9th Cir. 1984) (state antitrust claims under California’s Cartwright Act were properly removed to federal district court, and then should have been dismissed with prejudice because res judicata barred their relitigation); *Classen v. Weller*, 1981–2 Trade Cas. (CCH) ¶ 64,199 (N.D. Cal. 1981) (applying abstention doctrine, granted motion to stay federal antitrust action, even though federal court had exclusive jurisdiction, pending resolution of appeal in state court of grant of summary judgment on Cartwright Act claims, because issues underlying federal antitrust claims could be resolved through adjudication of state claims).


the principles of antitrust analysis. Some of the earlier literature on distribution problems under the antitrust laws is still the best introduction to the subject, and study of modern cases must begin with the two decisions of the United States Supreme Court in Sylvania and Monsanto.

One of the benefits to a dealer of suing the manufacturer under the antitrust laws is that an antitrust claim may enable the dealer to escape an arbitration provision in the dealer agreement. It is settled law that federal antitrust issues are not arbitrable, and that an agreement to arbitrate them is unenforceable.

However, antitrust claims are usually combined with other claims such as breach of contract or other state law claims. In that situation, the relevant inquiry becomes whether or not to stay arbitration in favor of permitting the antitrust action to proceed. Here the courts have held that the trial judge must evaluate the strength of the antitrust claims; weak antitrust claims should not require the stay of arbitration, or else a party to an arbitration agreement could simply postpone arbitration by filing an antitrust complaint. Circuit Judge Posner has suggested the best rule: "[W]hat ordering of arbitration and antitrust litigation will produce the quickest, soundest resolution of the complete controversy between the parties." Therefore if the court determines that a dealer's antitrust case should not be stayed pending arbitration, then the only two ways for the defendant manufacturer to influence the venue of the case are to attempt to enforce a forum selection clause if one exists, or to move for a change of venue under the applicable statutes.

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185. The seminal case was American Safety Equip. Corp. v. J.P. Maguire & Co., 391 F.2d 821 (2d Cir. 1968). The circuits that have considered the issue agree. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 723 F.2d 155, 162-63 (1st Cir. 1983), aff'd in part and rev'd in part, 105 S. Ct. 3346 (1985); University Life Ins. Co. of Am. v. Unimarc Ltd., 699 F.2d 846, 850-51 (7th Cir. 1983). Indeed, Mitsubishi Motors applied this doctrine to an international agreement with a Japanese automaker, and rejected arguments that the doctrine should not be applied to agreements with foreign countries. "We conclude that the nonarbitrability of antitrust issues is an American doctrine that is alive, well, justified both in its conception and in its application to at least the kind of international agreement we confront in this case—an agreement governing the sales and distribution of vehicles in the United States." 723 F.2d at 163 (emphasis in original).

186. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 723 F.2d 155, 169 (1st Cir. 1983) (district court must "assess the likelihood of success of the antitrust claims, a relevant factor in deciding whether or not to stay arbitration") (collecting cases), aff'd in part and rev'd in part, 105 S. Ct. 3346 (1985); University Life Ins. Co. of Am. v. Unimarc Ltd., 699 F.2d 846, 851 (7th Cir. 1983); Bos Material Handling v. Crown Controls Corp., 137 Cal. App. 3d 99, 111-12, 186 Cal. Rptr. 740 (1982) (a case handled by the author, in which a claim under California's Cartwright Act was stayed pending arbitration of the other controversies arising out of or relating to the dealer agreement); Sabates v. International Medical Centers, 450 So. 2d 514, 517 (Fla. Dist. Ct. App. 1984) (following federal precedent that antitrust claims are not arbitrable, claims under Florida Antitrust Act should not have been submitted to arbitration under an arbitration agreement in a medical services contract between a physician and a health care provider).


189. 28 U.S.C. §§ 1404(a) and 1406(a) (1984).
2. Types of Restraints

Although the various types of vertical restrictions possessed more legal significance prior to the Supreme Court's decision in Continental T.V. v. GTE Sylvania, Inc.,\(^{190}\) it is still conceptually helpful to distinguish among the various types of distributorship agreements. An *exclusive distributorship* or exclusive franchise is an agreement between the manufacturer and the distributor that the manufacturer will not sell to other outlets or distributors within the distributor's exclusive territory, and sometimes that the manufacturer will not sell directly to customers within that exclusive territory.\(^{191}\) Some of the old exclusive distributorships also included a promise by the dealer not to sell outside the territory.\(^{192}\) These provisions are no longer prevalent in distribution agreements.

The meaning of an "exclusive distributorship" was thoroughly explored by the Sixth Circuit in *Industrial Equipment Co. v. Emerson Electric Co.*,\(^{193}\) which reversed the trial court's holding that as a matter of law there existed an exclusive distributorship contract between the parties.\(^{194}\) In so doing, the appellate court ascribed to the term "exclusive distributor" the meaning that there is only one distributor in a particular geographic area.\(^ {195}\) The court also rejected the plaintiff's argument that an exclusive agreement was admitted because the manufacturer had failed to object to the plaintiff's statement that it expected to be the exclusive distributor. Although the manufacturer's conduct may have been "less than forthright," there was neither an acceptance by silence or inaction, nor an admission by the defendant of an exclusive contract.\(^ {196}\)

A *location clause* is an agreement that the dealer will sell only from a specified location; it is the designation of the place of business for which the franchise or license to sell is granted.\(^{197}\) An area of primary responsibility, which can be combined with

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\(^{190}\) 433 U.S. 36 (1977). This section focuses on marketing arrangements and restrictions which concern the territory, customers, or location of the distributor, and not upon other requirements that may be imposed upon a distributor. See, e.g., Kestenbaum v. Falstaff Brewing Corp., 575 F.2d 564, 571 (5th Cir. 1978) (requiring a dealer to advertise does not violate the Sherman Act), cert. denied, 440 U.S. 909 (1979).

\(^{191}\) See Bork, supra note 184, at 466; Note, supra note 184, at 796; Note, *Vertical Agreements to Terminate Competing Distributors: Oreck Corp. v. Whirlpool Corp.*, 92 Harv. L. Rev. 1160, 1164 (1979); Note, *Antitrust Law—Vertical Restraints—See Mandate of Schwinn Extended to Location Clause in Franchise Agreement*, 26 M case L. Rev. 629, 634 (1975).

\(^{192}\) An example of such an old-fashioned provision is found in Dobbins v. Kawasaki Motors Corp., 362 F. Supp. 54, 61 (D. Or. 1973).

\(^{193}\) 554 F.2d 276, 278 (6th Cir. 1977).

\(^{194}\) Id.

\(^{195}\) Id. at 286-87.

\(^{196}\) Id. at 287. The same result was reached in a case interpreting the meaning of "non-exclusive" in a license agreement. Eskimo Pie Corp. v. Whitelawn Dairies, 284 F. Supp. 987, 994, 989-90 (S.D.N.Y. 1966) (a non-exclusive license involves a bare right to use the trademark or patent, without any right to exclude others; contract at issue was a written agreement for a license for the sale of ice cream products, which granted a "non-exclusive right to purchase" products).

\(^{197}\) One of the leading cases upholding the use of the location clause was Salco Corp. v. General Motors Corp., 517 F.2d 567 (10th Cir. 1975). In that case, the location clause provided that the dealer "will not move to or establish a new or different location . . . without prior written approval of Buick." Id. at 575 n.7. The court in Salco described the manufacturer's "vital stake in the locations of its dealerships" as including the "adequate coverage of a market area" and the "economic viability of its dealership." Id. at 573. Salco was quoted with approval in Golden Gate Acceptance Corp. v. General Motors Corp., 597 F.2d 676, 680-81 (9th Cir. 1979), which affirmed the grant of summary judgment to the defendant manufacturer on claims under both the Sherman Act and the Dealer's Day in Court Act: "[T]here is
a location clause, is simply an area in which the distributor is supposed to concentrate its efforts.198 Sometimes attempts are made to distinguish between territorial restrictions and customer restrictions, or between restrictions embodying promises by the seller, and those embodying promises by the buyer.199 However, all of these restrictions are judged under the same general standards.

Although the term "franchise" is used somewhat loosely in the cases and in the literature, the essential distinction between a franchise agreement and a dealer agreement is that the franchising agreement is based upon a license for trademark rights.200

3. Significant Distinctions in Antitrust Analysis

In order to evaluate situations involving terminated dealers, it is important to remember several significant distinctions in antitrust analysis.201 The first and perhaps most basic distinction under section 1 of the Sherman Act is the category of per se offenses, as opposed to the types of conduct that are tested under the rule of reason.202

nothing in the Act which gives a dealer the right to dictate the location of its own choosing." (quoting Salco Corp. v. General Motors Corp., 517 F.2d 567, 573 (10th Cir. 1975)). Golden Gate recognized the validity under the antitrust laws of location provisions. Id. at 678 n.4.

198. "Such clauses allow manufacturers to insist upon intensive coverage of areas assigned to resellers but not to confine the resellers to their assigned territories." Bork, supra note 184, at 467. In Salco Corp. v. General Motors Corp., 517 F.2d 567, 573 (10th Cir. 1975), the dealers "had the entire Denver metropolitan area as a primary responsibility area and were free to sell to whomever they could persuade to purchase their automobiles." Under an area of primary responsibility provision, "the distributor or dealer is not barred from selling outside his territory but may have his franchise terminated if he does not achieve a certain sales volume within it." Note, Restricted Channels of Distribution Under the Sherman Act, 75 Harv. L. Rev. 795, 797 (1962). See, e.g., Schwimmer v. Sony Corp. of Am., 677 F.2d 946, 947 (2d Cir. 1982).


200. Comment, Article Two of the Uniform Commercial Code and Franchise Distribution Agreements, 1969 Duke L.J. 959, 975 ("At the core of all franchising is the licensing of a trademarked product or service."). See also H. Brown, Franchising: Realities and Remedies 10 (1973). One author has defined the "business format franchising situation" as "the vertical trademark license agreement, where the owner of a trademark licenses that trademark and allocates mutually exclusive territories to independent licensees that have no ownership or corporate connection with the trademark owner." Timberg, Territorial Restrictions on Franchisees: Post-Schwinn Developments, 19 Antitrust Bull. 205, 212 (1974).


The classic definition of per se offenses is contained in Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958): "[C]ertain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use."
The classic per se offense is price fixing.\textsuperscript{203} The Supreme Court has listed the offenses of horizontal allocation of territories\textsuperscript{204} and of division of markets, group boycotts, and tying arrangements\textsuperscript{205} as other per se offenses. However, in recent years the Supreme Court’s reluctance to find per se offenses has meant that this distinction between per se offenses and those under the rule of reason is becoming more a distinction between price-fixing and rule of reason inquiries.\textsuperscript{206} As the Fifth Circuit has stated: “So great is the power of the per se rule that we have named it ‘the trump card of antitrust law. When an antitrust plaintiff successfully plays it, he need only tally his score.’”\textsuperscript{207} In contrast, the rule of reason is one of antitrust’s “open-ended and fact-specific standards.”\textsuperscript{208} Unless price fixing is involved, most terminated dealer cases are judged according to the rule of reason. Therefore, an extended discussion of per se offenses is unnecessary.

A second fundamental distinction under section 1 of the Sherman Act is between unilateral and concerted action. Under section 1, an agreement between two or more persons is required before an offense exists.\textsuperscript{209} The Supreme Court in \textit{Monsanto} stated that this distinction was “not always clearly drawn by parties and courts.”\textsuperscript{210} This requirement often leads a plaintiff distributor to allege a conspiracy between the manufacturer and another distributor.

The third and fourth critical distinctions are between vertical and horizontal restraints, and restrictions upon intrabrand competition and interbrand competition.\textsuperscript{211} Both of these distinctions are discussed in connection with the \textit{Sylvania} opinion. In defending a terminated dealer action, each of these distinctions becomes a point of attack for the manufacturer. A plaintiff must take care to preserve and present the two distinct theories represented by a horizontal allocation and a vertical restriction. Counsel must present a correct jury instruction that separately sets forth these theories.\textsuperscript{212}

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\textsuperscript{204} United States v. Topco Assoc’s., 405 U.S. 596, 608 (1972).
\textsuperscript{205} Arizona v. Maricopa County Medical Soc’y, 457 U.S. 332, 344 n.15 (1982).
\textsuperscript{206} Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 15 n.25 (1984) (“The rationale for per se rules in part is to avoid a burdensome inquiry into actual market conditions in situations where the likelihood of anticompetitive conduct is so great as to render unjustified the costs of determining whether the particular case at bar involves anticompetitive conduct.”).
\textsuperscript{207} Sports Center v. Riddell, Inc., 673 F.2d 786, 790 n.3 (5th Cir. 1982). \textit{Accord Zidell Explorations v. Conval Int’l}, 719 F.2d 1465, 1471 (9th Cir. 1983) (“When conduct is per se illegal, the end does not justify the means.”).
\textsuperscript{211} For a discussion of these two distinctions, see \textit{Preston, Restrictive Distribution Arrangements: Economic Analysis and Public Policy Standards, 30 LAW & CONTEMP. PROBS. 505, 508 (1965). Intrabrand competition is competition among sellers of the same brand; interbrand competition is among sellers of different brands of a product or service. “Intra-brand competition is competition among Holiday Inn’s franchisees in the market of ‘Holiday Inn motel beds.’ Inter-brand competition is competition among Holiday Inns, Sheraton Inns, Ramada Inns, etc.”} American Motor Inns v. Holiday Inns, 365 F. Supp. 1073, 1088 n.4 (D.N.J. 1973), \textit{aff’d in part}, 521 F.2d 1230 (3d Cir. 1975).
\textsuperscript{212} A case the author argued, Reno-West Coast Distrib. Co. v. Mead Corp., 613 F.2d 722, 725-26 (9th Cir.), \textit{cert.}
4. The Sylvania Decision

Although much has been written213 about the Supreme Court’s decision in Continental T.V. v. GTE Sylvania, Inc.,214 for the purposes of this Article a brief summary of its holding together with a description of the other important principles and limitations upon the opinion will be sufficient. In Sylvania, the defendant manufacturer terminated the plaintiff’s distributorship after the plaintiff began to sell the product at an outlet other than the one approved by the manufacturer.215 Sylvania is significant in the distribution area because it overruled United States v. Arnold, Schwinn & Co.216 which had held that it was a per se violation of the Sherman Act for a manufacturer to seek to restrict either the territory or customers for the trade of an article after the manufacturer has parted with title over that article.217

Sylvania held that vertical territorial restrictions should be judged under the rule of reason rather than under the per se rule stated in Schwinn.218 The precise restriction at issue in Sylvania was a location clause219 which “limited the number of franchises granted for any given area and required each franchisee to sell his Sylvania products only from the location or locations at which he was franchised.”220 In deciding Sylvania, the Supreme Court set forth the principle that interbrand and not intrabrand competition “is the primary concern of antitrust law.”221 The Court reasoned that the benefits to the manufacturer from the promotion of interbrand competition outweighed the detriments to intrabrand competition.222 Accordingly, since Sylvania, the courts have been more willing to uphold vertical restrictions upon dealers because they promote intrabrand competition.223

Notwithstanding Sylvania’s treatment of intrabrand competition, the lower courts have continued to examine the intrabrand restrictions on distributor competi-

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214. 433 U.S. 36 (1977), aff’d 537 F.2d 980 (9th Cir. 1976).
217. Id. at 382. The Sylvania Court summarized the rule from Schwinn, 433 U.S. 36, 44-45 (1977).
219. This location provision was described in the en banc opinion of the Ninth Circuit, GTE Sylvania, Inc. v. Continental T.V., 537 F.2d 980, 983 (9th Cir. 1976), aff’d, 433 U.S. 36 (1977). What the restrictions did not encompass (anticompetitive practices, exclusive dealerships, and right of veto over new dealers) was also important, id. at 980. An interesting diagram contrasting Sylvania’s distribution policy with that in Schwinn was included in the original Ninth Circuit panel opinion, 1974–2 Trade Cas. (CCH) ¶ 75,072 (9th Cir.), withdrawn to be heard en banc, 1974–2 Trade Cas. (CCH) ¶ 75,435 (9th Cir. 1974).
221. Id. at 52 n.19.
222. Id. at 54-56.
223. After Sylvania, the Second Circuit held it to be reversible error to charge a jury that a purpose to restrict intrabrand competition would support a finding of liability. Borger v. Yamaha Int’l Corp., 625 F.2d 390, 397 (2d Cir. 1980).
tion in determining whether a vertical restraint passes muster under antitrust analysis.\(^{224}\) Underlying this scrutiny is the concern that competition between dealers will bid down the retail price, which in turn puts downward pressure on the wholesaler’s selling price; intrabrand dealer restrictions tend to eliminate this competitive pressure.\(^{225}\)

Two limitations upon the Supreme Court’s opinion in *Sylvania* are of equal importance to the antitrust analysis of dealership agreements. First, the Court emphasized that *Sylvania* dealt only with nonprice vertical restrictions.\(^{226}\) The Court reaffirmed the rule of per se illegality of price fixing.\(^{227}\) Therefore a vertical restriction that is part and parcel of a price fixing scheme will not withstand antitrust scrutiny. In the second significant restriction on the scope of the holding, the Court reaffirmed the rule of per se illegality for horizontal restrictions.\(^{228}\)

One line of cases illustrating the above analysis involves manufacturers’ responses to “bootlegging” practices by dealers. Apparently the only post-*Sylvania* appellate decision in which the plaintiff distributor prevailed in showing a vertical restraint to be unjustified was *Eiberger v. Sony Corp. of America*.\(^{229}\) Despite a well-drafted, non-exclusive franchise provision\(^ {230}\) which did not restrict the dealers to sales within a territory, or give them an exclusive right to sell within a territory, the Second Circuit held that the defendant’s warranty fee system constituted an unreasonable vertical restraint of trade.\(^ {231}\) In that case a Sony dealer began to sell Sony machines substantially below list price in a number of areas.\(^ {232}\) Other dealers began to complain about the sale of these “bootleg” machines.\(^ {233}\) The manufacturer’s warranty fee system required a selling dealer who failed to render warranty service to pay the scheduled warranty fee to the manufacturer.\(^ {234}\) However, the court found that in fact the manufacturer used the system to punish dealers selling outside their territory by debiting the warranty fee to the accounts of dealers to whom the manufacturer originally sold the machines.\(^ {235}\) In effect, “the amounts of the warranty

\(^{224}\) See, e.g., Graphic Prods. Distribs. v. Itek Corp., 717 F.2d 1560 (11th Cir. 1983).

\(^{225}\) Id. at 1572 n.20. See also Com-Tel, Inc. v. DuKane Corp., 669 F.2d 404, 412 (6th Cir. 1982) (“Although the primary concern of the antitrust laws is with interbrand competition, intrabrand competition is still a concern, especially in cases such as this where no benefits from increased interbrand competition may or did result from the vertical restrictions.”) (footnotes omitted); Eiberger v. Sony Corp. of Am., 622 F.2d 1068, 1081 (2d Cir. 1980) (an anticompetitive impact on intrabrand competition can alone support a finding that section 1 of the Sherman Act has been violated); Cernuto, Inc. v. United Cabinet Corp., 595 F.2d 164, 166 n.11 (3d Cir. 1979) (“[I]ntrabrand competition has not been of so little importance as never to merit the protection of a per se rule.”).


\(^{227}\) Id. at 51 n.18.

\(^{228}\) 433 U.S. at 58 n.28. The classic definition of, and distinction between, horizontal and vertical restrictions is contained in United States v. Topco Assocs., 405 U.S. 596, 607–08 (1972).\(^ {229}\) 622 F.2d 1068 (2d Cir. 1980).

\(^{230}\) Id. at 1070 n.1.

\(^{231}\) Id. at 1070.

\(^{232}\) Id. at 1071–72.

\(^{233}\) Id. at 1077.

\(^{234}\) Id. at 1072.

\(^{235}\) Id. at 1072–73. The facts in *Eiberger* justified this result. According to the record, one Sony dealer “stormed into the store of an unauthorized competitor and opened boxes on the shelves to obtain the serial numbers of the Sony dictation equipment inside.” Id. at 1073. When the complaining Sony dealer was arrested for trespass, the manufacturer “interceded on his behalf with the local prosecutor.” Id. at 1073 n.8.
fees were large enough to eliminate any profit that a dealer would make on sales to unauthorized dealers for resale.’”

In contrast to the Second Circuit’s decision in Eiberger, the Fifth Circuit has twice considered alleged restrictions upon bootlegging practices, and both times has found in favor of the manufacturer. Parsons v. Ford Motor Co. affirmed a grant of summary judgment in favor of defendants in an antitrust action by a plaintiff who was engaged in the interdealership transfer of new motor vehicles. In that case the automobile manufacturer used an allocation system to distribute its models that were in short supply. While the conduct at issue was described differently by the two parties, the Fifth Circuit affirmed the grant of summary judgment as to the claims under section 1 of the Sherman Act, for lack of significant probative evidence of conspiracy, holding that “enforcement of the company’s fleet allocation system policy is not equivalent to conspiracy.”

Six weeks after Parsons was decided, a different panel of the Fifth Circuit in Sports Center v. Riddell, Inc. affirmed a directed verdict in favor of dealers that had been joined as defendants, and affirmed a judgment that had been entered in favor of the defendant manufacturer upon a jury verdict, in an action by a sporting goods dealer alleging that the defendants had conspired to damage its business in violation of section 1 of the Sherman Act. The manufacturer maintained a "bootleg' ban' that was described as a policy of discouraging sales by its dealers to anyone other than ultimate consumers. After reviewing the distinction between vertical and horizontal restraints, the Fifth Circuit concluded that there was no section 1 violation. Parsons and Sports Center indicate that the manufacturer has significant freedom to enforce its dealer policies without incurring liability for a conspiracy under section 1 of the Sherman Act.

5. The Monsanto Decision

The second leading Supreme Court opinion in the terminated dealer area is Monsanto Co. v. Spray-Rite Service Corp. Monsanto resolved a conflict among the federal circuits regarding the sufficiency of the evidence that must be produced by an
antitrust plaintiff to survive a motion for a directed verdict in a case in which the plaintiff distributor is attempting to prove a conspiracy to set resale prices. In that case the Seventh Circuit had held that "proof of termination following competitor complaints is sufficient to support an inference of concerted action." The Supreme Court rejected this standard but affirmed the award of damages under a new standard that it formulated.

After discussing the "two important distinctions" between concerted and independent action, and between concerted action to set prices and concerted action on non-price restrictions, the Court held that the Seventh Circuit's standard permitted a price fixing agreement to be inferred merely from the existence of complaints. In contrast, the Court's standard required the antitrust plaintiff to present evidence that reasonably tended to prove that the defendant manufacturer and others had consciously pursued a common scheme designed to achieve an unlawful objective. This latter standard restricts the latitude granted to a finder of fact to infer an unlawful motive on the part of a defendant manufacturer that has terminated a dealer.

6. The Application of Antitrust Principles to Terminated Dealer Situations: The Dealer Substitution Cases

Older Supreme Court cases have addressed broad questions concerning the lawfulness of a manufacturer's entire method of distribution, and have held some distribution systems unlawful. However, in recent years courts have not found it necessary to address arguments that entire distribution systems are violative of the antitrust laws. The facts of each situation should provide sufficient basis for a determination of the plaintiff’s claims without the necessity to reach these questions. At least in the absence of class action certification, this reluctance on the part of the courts is advisable, if only because of the possible severe adverse economic effects of such a finding on a manufacturer and each of the members of its distribu-

245. Spray-Rite Serv. Corp. v. Monsanto Co., 684 F.2d 1226, 1238 (7th Cir. 1982).
247. Id. at 760-64.
248. Id. at 764.
249. Id.
250. See Borger v. Yamaha Int'l Corp., 625 F.2d 390, 397 n.4 (2d Cir. 1980) (an unlawful purpose is not sufficient to establish a Sherman Act violation). Cf. United States v. United States Gypsum Co., 438 U.S. 422, 436 n.13 (1978) (a civil violation of the Sherman Act can be established by proof of either purpose or effect). Together with Sylvania's emphasis on the anticompetitive effects of conduct alleged to violate the Sherman Act, these cases undercut the conventional wisdom that an antitrust plaintiff had to show a purpose or effect to harm competition.
tion network. Accordingly, most terminated dealer disputes arise when a manufacturer's dissatisfaction with a single dealer leads the manufacturer to choose another dealer.

This section of the Article examines the permissibility of the "dealer switch" or "dealer substitution" actions of a manufacturer. Both Monsanto and Sylvania left undisturbed a large body of case law involving the dealer switch or dealer substitution situation. The three leading opinions in this area are from the Ninth,253 Sixth,254 and Fifth255 Circuits. Together they establish a proposition that has been widely applied in antitrust litigation brought by exclusive distributors: a manufacturer does not violate the Sherman Act by terminating a dealer, even if the termination is done pursuant to an agreement with the prospective new dealer. This rule is sensible in view of the fact that unless a manufacturer is vertically integrating256 or is going out of business, the manufacturer's interest will almost always lead it to search for and negotiate with a potential new distributor to replace a dealer that is to be terminated. If this conduct were forbidden, then the manufacturer's legitimate interest in maintaining adequate service to its customers would be jeopardized.

The leading case in this area is Joseph E. Seagram & Sons, Inc. v. Hawaiian Oke & Liquors, Ltd.,257 in which the plaintiff liquor distributor alleged that the defendant distiller had conspired to terminate the distributorship and to replace plaintiff with another dealer. In dismissing the action, the Ninth Circuit set forth the classic statement of the law in this area:

We think it indisputable that a single manufacturer or seller can ordinarily stop doing business with A and transfer his business to B... There is language in many of those cases which, taken out of context, plaintiff construes as meaning that, if the seller agrees with a third party—a competitor of the seller, for example, or a competitor of A—to do the same thing, a per se violation of section 1 has occurred. This obviously cannot mean an agreement with B, the new distributor; he could not accept the distributorship without agreeing to do so. And the decisions... make it clear that the decision of the seller to transfer his business from A to B is valid even though B may have solicited the transfer and even though the seller and B may have agreed before the seller terminates his dealings with A.258

Equally significant with respect to the ability of a plaintiff dealer to withstand a preliminary motion is the court's holding that the plaintiff dealer's evidence that it was in fact a good dealer did not support an inference of anticompetitive intent.259 Hawaiian Oke has been followed in numerous cases.260 Its holding has been

256. See discussion of vertical integration infra notes 328-35.
258. Id. at 78 (emphasis added).
259. Id.
260. See, e.g., Busbie v. Stenocord Corp., 460 F.2d 116, 119–20 (9th Cir. 1972) (The most that evidence that distributor was a good dealer demonstrates is that the defendant may have been mistaken in judging the quality of its distributor's performance.); Bay City-Abrahams Bros., Inc. v. Estee Lauder, Inc., 375 F. Supp. 1206, 1215 (S.D.N.Y. 1974) (granting the defendants' motion for summary judgment in an action by a plaintiff cosmetic distributor against a
strengthened by *Sylvania*’s emphasis upon the requirement of “demonstrable economic effect” for an antitrust violation and *Monsanto*’s emphasis upon the distinction between concerted and independent action.

Certain refinements and additions to the Ninth Circuit’s holding in *Hawaiian Oke* should be noted. The Ninth Circuit in *Golden Gate Acceptance Corp. v. General Motors Corp.* summarized the applicable rule as follows:

It has been consistently held in this circuit that it is not a violation of the Sherman Act for a manufacturer to conspire with others to simply switch distributors at one of its exclusive franchises and to cease doing business with a former dealer. Thus, as a matter of law, the appellants’ antitrust charges in their complaint failed to state a claim under the Sherman Act. Moreover, it is clear from the record below that, even given the requisite presumptions in appellants’ favor, GM’s termination of the Agreement was caused directly and justifiably by Kohlenberg’s and the Dealership’s breach of the Agreement. Consequently, the district court’s grant of summary judgment as to the antitrust claims was proper.

The following year the Ninth Circuit quoted this passage from *Golden Gate Acceptance Corp.*, adding that the desire to replace an ineffective dealer with a more efficient one is a proper basis for termination.

Although each case under the Sherman Act must be judged on its own facts, these cases are of broad applicability because the basic facts underlying most of them are common to the terminated dealer situation: a manufacturer seeks to terminate one dealer, replacing that dealer (either simultaneously or at a later date) with a new dealer.

The second of the three leading cases, the Sixth Circuit’s decision in *Ace Beer Distributors v. Kohn, Inc.*, affirmed the dismissal of the complaint in an antitrust action for failure to state a claim upon which relief could be granted. The plaintiff was an exclusive distributor of beer, and one of the defendants was the plaintiff’s sole source and supply of that product. The court held that the defendant brewer and others did not violate the Sherman Act by agreeing to eliminate the plaintiff as a beer distributor, the brewer thereafter conducting its business through a cosmetics manufacturer. After discussing *Hawaiian Oke* and other cases, the court stated: “This result is not altered by proof that the cutoff distributor was a ‘good dealer,’ as plaintiff contends.” *Accord Marquis v. Chrysler Corp.*, *577 F.2d 624, 640* (9th Cir. 1978) (“Furthermore, even if Marquis could show that his dealership was satisfactory, that would not compel a different result.”).

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263. *597 F.2d 676* (9th Cir. 1979).
264. *Id. at 678-79* (footnotes omitted).
265. *Chandler Supply Co. v. GAF Corp.*, *650 F.2d 983, 989* (9th Cir. 1980).
267. *Oreck Corp. v. Whirlpool Corp.*, *579 F.2d 126* (2d Cir.) (en banc), *cert. denied*, *439 U.S. 946* (1978); *Note, Vertical Agreements to Terminate Competing Distributors: Oreck Corp. v. Whirlpool Corp.*, *92 Harv. L. Rev. 1160, 1166* (1979); *Bushie v. Stenocord Corp.*, *460 F.2d 116, 120* (9th Cir. 1972) (fact that defendant had no outlet in Phoenix for months after termination of distributor was of no significance).
269. *Id. at 287.
270. *Id. at 285.
another distributor. The Sixth Circuit made plain Ace Beer's precedential vitality in Byars v. Bluff City News Co.

Franchisees and distributors which have been unilaterally terminated have discovered to their chagrin that ordinarily the law offers them no remedy absent proof that a conspiracy against them took place. An agreement with another distributor to replace the terminated distributor does not count as a conspiracy. Even the use of unfair business practices as part of the termination may not invoke sanction under the antitrust laws.

Although the Ninth Circuit has limited these more recent statements of the Hawaiian Oke doctrine, stating that they do not apply to the termination of a price-cutting distributor at the request of a competing distributor, that court has made explicit a concept implicit in the Hawaiian Oke line of cases: A terminated distributor complaining of a dealer switch situation may not show an anticompetitive purpose or effect by demonstrating that the manufacturer's new dealer arrangement had the effect of cutting off the terminated dealer's source of parts, or that the terminated dealer was damaged by the termination, or that the termination cost the terminated dealer a large part of its business. The Ninth Circuit in Calculators Hawaii v. Brandt, Inc. held that refusal to sell with a resulting loss of business by the distributor is insufficient to prove anticompetitive purpose of effect. A.H. Cox & Co. v. Star Machinery Co. contains the best summary of the principles in this area. Cox emphasized that most dealer terminations or substitutions do not adversely affect market competition. Unless a manufacturer is going out of business, it will almost always seek to replace a terminated dealer with another dealer. Accordingly, these factual scenarios will not only preclude a finding of Sherman Act liability, but make likely the success of a motion to dismiss or for summary judgment.

The Third Circuit followed the Ninth Circuit's decision in Hawaiian Oke in Ark Dental Supply Co. v. Cavitron Corp., an action in which a subsidiary's output of a product was restricted to sales to the division of its parent, effectively cutting off a distributor. Ark Dental Supply is also significant because the Third Circuit joined the Ninth Circuit in rejecting the intra-corporate conspiracy doctrine, holding that the corporate defendant's business decision to sell only to the dealers of one of its

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271. Id. at 286–87.
273. 609 F.2d 843 (6th Cir. 1979).
274. Id. at 854–55 (citations omitted).
276. 724 F.2d 1332, 1337–38 (9th Cir. 1983).
277. 653 F.2d 1302, 1306–07 (9th Cir. 1981). See also Hood v. Tenneco Texas Life Ins. Co., 739 F.2d 1012, 1018 (5th Cir. 1984) (5% market share of the supplier meant that the dealer termination "cannot have an adverse effect on competition.").
divisions meant that no plurality of persons was necessary for a finding of a violation of section 1 of the Sherman Act.279

The third leading opinion, the Fifth Circuit's Burdett Sound v. Altec Corp.,280 affirmed an award of summary judgment for a manufacturer in an action by a terminated distributor. In discussing "the none too novel question of whether a manufacturer violates the Sherman Act when it terminates a business relationship with one of its distributors and contracts with the new firm,"281 the Fifth Circuit summarized the principles of Hawaiian Oke and Ace Beer, and rejecting the plaintiff's argument that the manufacturer's commission of various unfair trade practices served to distinguish that case from other distributor substitution cases.282 After quoting Hawaiian Oke, the court summarized the applicable rule:

Lest any other former distributors succumb to the temptation of treble damages, we reiterate that it is simply not an antitrust violation for a manufacturer to contract with a new distributor, and as a consequence, to terminate his relationship with a former distributor, even if the effect of the new contract is to seriously damage the former distributor's business.283

This much cited Fifth Circuit decision has been applied to a variety of fact situations to uphold the elimination of distributors or dealers and refusals to deal in distribution situations.284 Both Burdett Sound285 and Ace Beer286 noted that to switch

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279. Id. at 1094 n.1. The Ninth Circuit opinion in Hawaiian Oke, considered a similar issue and likewise held that no conspiracy can exist between divisions of a corporate defendant. Perhaps the leading case in this area is Nelson Radio & Supply Co. v. Motorola, Inc., 200 F.2d 911 (5th Cir. 1952), cert. denied, 345 U.S. 923 (1953). Accord Domed Stadium Hotel v. Holiday Inns, 732 F.2d 481, 486-87 (5th Cir. 1984). In view of the critical distinction between unilateral and concerted action, these holdings are significant in terminated dealer cases because frequently there will be an absence of any substantial indication that the defendant manufacturer agreed with a separate entity to terminate the plaintiff. Consequently, there is no Section 1 violation because the necessary plurality of persons is lacking. See Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984) (a wholly-owned subsidiary is incapable of conspiracy with its parent under the Sherman Act as a matter of law).

280. 515 F.2d 1245, 1246 (5th Cir. 1975).

281. Id. at 1246.


283. 515 F.2d at 1249, quoted with approval in Dunn & Mavis, Inc. v. Nu-Car Driveaway, 691 F.2d 241, 244 n.1 (6th Cir. 1982).

284. See Graphic Prods. Distribs. v. Itek Corp., 717 F.2d 1560, 1572 n.20 (5th Cir. 1983) ("We have emphasized time and time again that mere termination of a dealer—even an arbitrary and unfair termination—does not constitute an antitrust violation actionable under the treble damages provisions of the Clayton Act."); Carlson Mach. Tools v. American Tool, 678 F.2d 1253, 1260 (5th Cir. 1982) ("If a manufacturer negotiates, or reaches agreement, with a new distributor prior to his substitution of distributors, such negotiations do not, without more, amount to a violation of the antitrust law . . . ."); Joe Regueira, Inc. v. American Distilling Co., 642 F.2d 826, 831-32 (5th Cir. 1981) (affirming summary judgment for defendant in antitrust action by terminated beverage distributor); Moeniter Butane, Inc. v. Stewart Co., 651 F.2d 292, 296-97 (5th Cir. 1981); Daniels v. All Steel Equip., 590 F.2d 111, 113 (5th Cir. 1979) (affirming summary judgment for defendant in antitrust action for manufacturer's termination of sales representative); Aviation Specialities v. United Technologies Corp., 568 F.2d 1186, 1192 (5th Cir. 1978) ("As a manufacturer, Pratt-Whitney has the right to select its customers and to refuse to sell its goods to anyone for reasons sufficient to itself."); H & B Equip. Co. v. International Harvester Co., 577 F.2d 239 (5th Cir. 1978) (even a conspiracy between a supplier and its distributor to put a second distributor out of business does not violate the Sherman Act); Northwest Power Prods. v. Omark Indus., 576 F.2d 83, 86 (5th Cir. 1978) (affirming summary judgment granted to defendant in antitrust action by terminated distributor).

285. 515 F.2d 1245, 1248 (5th Cir. 1975). "A mere unilateral change of distributors is not an unusual business practice, nor is it a violation of the antitrust laws."

286. 318 F.2d 283, 287 (6th Cir. 1963). Such a substitution "is not an unusual business procedure."
or substitute distributors is not an unusual business practice, recognizing the legality of this business decision.

7. The Dual Distribution Doctrine

Whether the relationship between the dealer or franchisee, and the manufacturer or franchisor who also sells the product or service direct to customers is a vertical one is the subject of the dual distribution problem. Ever since the Third Circuit first dealt with this problem in 1975 in American Motors Inn v. Holiday Inns,287 the courts and commentators288 have wrestled with this problem. In Holiday Inns, the Third Circuit found that operating hotels and franchising others to operate hotels in the same area combined to support a conclusion that a horizontal conspiracy to divide territories existed.289 Plaintiffs will continue to raise the dual distribution argument because (a) frequently a manufacturer both distributes its own products directly to customers and employs independent distributors to sell its products; and (b) a finding that the defendant manufacturer is in competition with its dealers at the same market level enables the plaintiff dealer to argue that the per se rule applies to the defendant’s conduct. In other words, the plaintiff’s goal is to avoid the rule of reason treatment for non-price vertical restraints, and to obtain the benefit of the per se rule against horizontal restraints, even in the absence of price fixing.

Cases holding the per se rule to apply to the dual distribution problem have simply reasoned that (a) the fact that the manufacturer or franchisor sells its product or service directly to customers means that it sells on the same level of the market as its distributor or franchisee (i.e., the defendant is both supplier to and a competitor of its dealer or franchisee); and (b) therefore any agreement between the manufacturer and one or more of its dealers or franchisees, to plaintiff’s detriment, constitutes an unlawful horizontal allocation of territory or customers.290

More recently, the Second,291 Fifth,292 Sixth,293 and Ninth294 Circuits have held that a dual distribution system must be evaluated according to rule of reason.295 These

287. 521 F.2d 1230, 1253-54 (3d Cir. 1975).
288. Several articles discussing the theory of dual distribution are found in Symposium, Sherman Act Implications of Dual Distribution, 48 Alemnn L.J. 1795 (1979). See also Brett & Wallace, Sylvania and the Dual Distribution Problem, 26 N.Y.L. Sci. L. Rev. 971 (1981) (approaches to distribution have been varying and inconsistent); Rill, Non-Price Vertical Restraints Since Sylvania: Market Conditions and Dual Distribution, 52 Alemnn L.J. 95, 107 (1983) ("The clear trend of decisions is toward viewing dual distributors’ restraints as vertical.").
293. Davis-Watkins Co. v. Service Merchandise, 686 F.2d 1190, 1201-02 (6th Cir. 1982).
295. Accord Marquis v. Chrysler Corp., 577 F.2d 624, 640 n.27 (9th Cir. 1978) ("The dual distribution system employed to market Dodge products does not in itself violate the antitrust laws."). The Sixth Circuit has reserved ruling on the dual distribution issue. Barnsky Oils v. Union Oil Co., 665 F.2d 74, 80 n.10 (6th Cir. 1981).
courts reasoned that the per se rule is inapplicable to vertical nonprice restraints, and that the restraints involved in a dual distribution system remain within the definition of a vertical restraint. In reaching its conclusion that a dual distribution system must be evaluated under the rule of reason, the Fifth Circuit in Abadir & Co. v. First Mississippi Corp., defined a vertical restraint as one which "the party imposing the agreement has the potential economic advantages typically available to a supplier in a vertical market-distributing agreement." This analysis is consistent with Syvania's emphasis upon the effects on competition of a practice challenged under the Sherman Act.

Faced with the circuits' conflicting pronouncements, the lower courts have analyzed the strength of the plaintiff's showing of any restraint and the effects on interbrand competition in deciding if the dual distribution doctrine should apply. For example, Midwestern Waffles v. Waffle House analyzed a dual distribution problem by considering both the effects on competition and the right of the franchisor to select the parties to whom and through whom it would sell. Dual distribution itself is not unlawful. As is always true in antitrust analysis, the proper inquiry is the effect on competition. The dual distribution system is most likely to be upheld when:

(a) the manufacturer sells at the same prices to the company-owned and to the independent distributors;
(b) the company-owned distributor is not operating at a loss for extended periods of time, eliminating a charge of predatory pricing;
(c) the manufacturer avoids actions to coerce adherence to its suggested prices;
(d) the company-owned distributor is not favored in allocations of products, parts, or other services (i.e., dealer service training);
(e) termination, nonrenewal, or replacement of an independent distributor with a company-owned outlet is performed in an even-handed manner and in accordance with the dealer agreement.

The national account practice of many manufacturers presents a variation of the dual distribution problem. Commonly, a manufacturer or regional supplier reserves to itself certain large accounts, which are frequently called "national accounts." The rationale for the reservation of these accounts is that they are such large customers that (a) the manufacturer may wish to give large volume discounts on orders, best negotiated directly between the customer and the manufacturer; and (b) national accounts require more attention and more servicing than do smaller accounts, also best provided directly by the manufacturer. At least two federal circuits have held

296. See supra note 211.
297. 651 F.2d 422 (5th Cir. 1981).
298. Id. at 427 (footnote omitted). The court also stated: "Thus, vertical market-distributing agreements must truly be imposed by a supplier, in fact. Market-distributing agreements which are initiated by distributors are horizontal, even if the supplier is nominally a party to the contract." Id. at 427 n.5.
300. 1983-2 Trade Cas. (CCH) ¶ 65,567 (N.D. Ga. 1982), aff'd per curiam, 734 F.2d 705 (11th Cir. 1984).
301. For a description of the place of national accounts in a distribution program, see Schwimmer v. Sony Corp. of Am., 677 F.2d 946, 947 (2d Cir.), cert. denied, 103 S. Ct. 362 (1982). Schwimmer's description is not unlike the typical national accounts program, which seeks to segregate volume accounts for attention by the manufacturer.
that a distribution complaint about a national accounts program must be evaluated under the rule of reason, rather than under the per se rule.

_H&B Equipment Co. v. International Harvester Co._302 affirmed a directed verdict for the manufacturer in a distributor's antitrust action. One of the dealer's theories alleged a violation of section 1 of the Sherman Act because "International Harvester, as part of its dealership arrangement, blocked H&B from selling to certain 'house account' customers, including governments and rental yards."303 Since the source of the restraints was vertical, not horizontal, the Fifth Circuit held that the rule of reason applied.304

_Bostick Oil Co. v. Michelin Tire Corp.,_305 a truck tire distributor's antitrust action against a manufacturer, arose from the termination of a distribution contract. The Fourth Circuit reversed the grant of the manufacturer's motion for a directed verdict under theories for recovery under the Sherman Act and under the South Carolina Unfair Trade Practices Act.306 The Fourth Circuit recognized that the national accounts program was founded not upon a territorial restriction, but rather upon a customer restriction.307 The court held that a manufacturer's central billing program is not per se illegal under the Sherman Act if the program was voluntary (i.e., dealers could join or decline to join and yet remain dealers) and if the manufacturer set no minimum resale price.308 Nevertheless, the court reversed the grant of the directed verdict motion because the manufacturer had pressured the dealers and imposed an "effective barrier to dealer price competition . . ."309

8. Actions Constituting Only Unfair Competition or Breach of Contract

A number of other antitrust principles support the conclusion that the usual termination of a distribution agreement is not an antitrust violation. Fundamentally, the antitrust laws were enacted for the protection of competition, not competitors.310 Accordingly, unfair competition and other business torts are not antitrust violations; indeed, the policies underlying the law of unfair competition are inconsistent with those underlying antitrust law.311 Nor is breach of contract an antitrust

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302. 577 F.2d 239 (5th Cir. 1978).
303. Id. at 243.
304. Id. at 245-46.
305. 702 F.2d 1207 (4th Cir. 1983).
306. Id. at 1209-10.
307. In support of its claim that the manufacturer restricted dealer territories, or customers to whom products could be transferred, the court stated that the plaintiff dealer offered at most only "a strained view of the potential of the National Accounts program as a means of overseeing dealer-customer contact. These theories were properly dismissed." Id. at 1218 n.22.
308. Id. at 1216.
309. Id. at 1217.
311. Hunt v. Crumboch, 325 U.S. 821, 826 (1945) ("That Act does not purport to afford remedies for all torts committed by or against persons in interstate commerce."), followed in Stifel, Nicholas & Co. v. Dain, Kalman & Quail, Inc., 578 F.2d 2156, 2161 (8th Cir. 1978); Sutliffe, Inc. v. Donavan Cos., 727 F.2d 648, 655 (7th Cir. 1984); L.A. Draper & Son v. Wheelabrator-Frye, Inc., 735 F.2d 414 (11th Cir. 1984); Mid-West Underground Storage v. Porter, 718 F.2d
offense. Therefore, the manufacturer's decision not to renew a distributorship agreement does not violate antitrust law.

9. Relief to a Terminated Distributor under Section 2 of the Sherman Act

A dealer's claims against a manufacturer under section 2 of the Sherman Act usually fail because the three section 2 offenses (monopolization, attempt to monopolize, and conspiracy to monopolize) are oriented toward market structure and conduct, a much broader analytical focus than a particular distributor's situation. Hence, terminated dealers rarely prove offenses under section 2 of the Sherman Act because the distributor does not demonstrate the specific intent to monopolize, a

493 (10th Cir. 1983); University Life Ins. Co. of Am. v. Unimarc Ltd., 699 F.2d 846, 852 (7th Cir. 1983) ("Unfair competition in the tort sense does not violate the federal antitrust laws, and to convert a claim of unfair competition into a federal antitrust claim requires more than the addition of antitrust boilerplate."); A.H. Cox & Co. v. Star Mach. Co., 653 F.2d 1302, 1308 (9th Cir. 1981) ("Similarly, allegations of unfair competition by the new dealer are insufficient to raise antitrust concerns in this case."); Byars v. Bluff City News Co., 609 F.2d 843, 855 (6th Cir. 1979) ("Even the use of unfair business practices as part of the termination may not invoke sanction under the antitrust laws."); Kestenbaum v. Falstaff Brewing Corp., 575 F.2d 564, 571 (5th Cir. 1978) ("Dealings between a manufacturer and its agents may be arbitrary, unfair, or lacking in good business judgment, but, without more, they will not violate the Act."); cert. denied, 440 U.S. 909 (1979); Hill v. A-T-O, Inc., 353 F.2d 1349, 1355-56 (2d Cir. 1976) (plaintiff's claim alleging that the defendant through fraudulent misrepresentations intended to and did restrain trade was properly dismissed); Drellis v. Wilson, 529 F.2d 170, 172-73 and n.1 (9th Cir. 1975) (no Sherman Act claims found in dealer terminations involving acts of unfair competition such as "corporate executive unfaithfulness and intracorporate mismanagement," lack of proper notice of termination, pirating of employees, taking over favored accounts, and similar activities); Ace Beer Distribs., Inc. v. Kohn, Inc., 318 F.2d 283, 286 (6th Cir.) ("It is well settled that tortious conduct against one engaged in interstate commerce or which has an effect on interstate commerce does not automatically constitute a violation of the Sherman Act."); cert. denied, 375 U.S. 922 (1963); Merkle Press v. Merkle, 519 F. Supp. 50, 54 (D. Md. 1981) ("Courts must be circumspect in converting ordinary business torts into violations of the antitrust laws. To do so would be to 'create a federal common law of unfair competition' which the antitrust laws do not automatically constitute a violation of the Sherman Act."); Uniroyal, Inc. v. Hoff & Thames, Inc., 511 F. Supp. 1060 (S.D. Miss. 1981) (elimination of dealer's exclusive territory was not a section 1 violation; Sherman Act is not "a panacea for all business affronts which seem to fit nowhere else" and there was "no antitrust wheat" among plaintiff's "proffered bushel of speculative chaff"); Groten Mach. Works v. Hess, 496 F. Supp. 945 (N.D. Ill. 1980) (a conspiracy between a company's former manager of engineering and a competitor to obtain the company's proprietary information was pro-competitive, even if illegal, and not violative of the Sherman Act; the antitrust laws were enacted for the protection of competition, not competitors); B&B Oil & Chem. Co. v. Franklin Oil Corp., 293 F. Supp. 1313, 1317 (E.D. Mich. 1968) ("But the antitrust acts do not purport to formulate a code of business morality. They are not tablets of stone for the conduct of business generally."); But see Havoco of Am., Ltd. v. Shell Oil Co., 656 F.2d 549, 556 (7th Cir. 1981); Juneau Square Corp. v. First Wis. Nat'l Bank, 624 F.2d 798, 812-13 (7th Cir. 1980).

312. Unijax, Inc. v. Champion Int'l, 683 F.2d 678, 684 n.12 (2d Cir. 1982) ("In numerous cases filed in federal court, the parties cloak simple contract or fraud claims in the mantle of antitrust violations."); Reisner v. General Motors Corp., 671 F.2d 91 (2d Cir. 1982) (facts behind a commercial venture that went sour would not support plaintiff's effort to convert a contract claim into an antitrust conspiracy claim; antitrust laws were not designed to police the performance of private contracts); Bowdish v. Eaton Corp., 1981-1 Trade Cas. (CCH) ¶ 63,913 (M.D.N.C. 1981) (motion for summary judgment granted in favor of a lift truck manufacturer on antitrust claims brought by a terminated dealer; a contract dispute between a dealership and the supplier may not be cast in antitrust terms); Williams v. Kleaveld, 1982-2 Trade Cas. (CCH) ¶ 64,919 (W.D. Mich. 1981) ("The antitrust laws are not a high powered version of the laws relating to breach of contract.").

313. For example, J.H. Westerbeke Corp. v. Onan Corp., 580 F. Supp. 1173 (D. Mass. 1984), held that a decision not to renew an ineffective distributor where the dealer had been devoting increasing attention to other products at the expense of the defendant's products was not a violation of section 2 of the Sherman Act. Similarly, at least two circuits have recognized that without more, a short notice cancellation provision in a dealer agreement is not an antitrust violation. Oseborn v. Sinclair Ref. Co., 324 F.2d 566, 575 (4th Cir. 1963), cert. denied, 366 U.S. 963 (1964); Englander Motors v. Ford Motor Corp., 267 F.2d 11, 15 (6th Cir. 1959). In another case brought by an exclusive distributor of fluorescent lamp bulbs against the manufacturer and its parent, the court rejected the plaintiff's attempt to create an antitrust case out of the problems that had arisen concerning the oral agreement granting rights in a five state area. Universal Lite Distr., Inc., Northwest Indus., 452 F. Supp. 1206, 1211 (D. Md. 1978), aff'd in part and rev'd in part, 602 F.2d 1173 (4th Cir. 1979).

DEFENDING TERMINATED DEALER LITIGATION

The distributor usually fails to prove that the defendant's actions were predatory or unreasonable,\footnote{316. Walker v. U-Haul Co., 734 F.2d 1068, 1078 (5th Cir. 1984); Calculators Hawaii v. Brandt, Inc., 724 F.2d 1332, 1339 (9th Cir. 1983).} or the defendant willfully acquired or maintained its market power through the use of predatory conduct.\footnote{317. United States v. Grinnell Corp., 384 U.S. 563, 570-71 (1966) (it is necessary to prove two elements to support a section 2 violation: "(1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident."); General Business Sys. v. North Am. Philips Corp., 699 F.2d 965, 981 (9th Cir. 1983); Cowley v. Braden Indus., 613 F.2d 751, 756 (9th Cir.), (finding no evidence that the manufacturer "acquired or maintained its market position through the use of predatory conduct as required by the second part" of the Grinnell test), cert. denied, 446 U.S. 965 (1980); J.H. Westerbeke Corp. v. Onan Corp., 580 F. Supp. 1173 (D. Mass. 1984).}

Aside from these bases for rejection of a dealer's antitrust claims, most section 2 claims brought by distributors will fail to surmount the hurdle presented by the principle that every manufacturer has a natural monopoly over its own product.\footnote{318. United States v. E.I. duPont de Nemours & Co., 351 U.S. 377, 393 (1956).}

Accordingly, numerous cases have held that antitrust claims by terminated dealers are not stated under section 2 of the Sherman Act when the terminated dealer alleges that the manufacturer has attempted to monopolize or has abused its monopoly in the sale or distribution of its own products.\footnote{319. A manufacturer's lawful natural monopoly is especially strong when its product is trademarked. Discussing the law applicable to antitrust claims by terminated dealers, the Sixth Circuit recently recognized that a manufacturer's monopolization of its business was lawful, and went on to quote with approval Justice Stevens' opinion (when he was on the Seventh Circuit) which explained that proof of a manufacturer's monopoly over its own product is not proof of dominance in an economic market. Further, even if the manufacturer's own product were the relevant market, a manufacturer's decision regarding termination or

\footnote{320. Discussing the law applicable to antitrust claims by terminated dealers, the Sixth Circuit recently recognized that a manufacturer's lawful natural monopoly of its business was lawful, and went on to quote with approval Justice Stevens' opinion (when he was on the Seventh Circuit) which explained that proof of a manufacturer's monopoly over its own product is not proof of dominance in an economic market.}

\footnote{321. Id. at 244.}
nonrenewal of a dealer could not constitute a section 2 violation because the identity of a particular dealer cannot affect the market.\textsuperscript{323}

In sum, terminated dealers’ antitrust claims under section 2 of the Sherman Act rarely surmount the hurdles presented by the elements of a section 2 offense. Isolated decisions about distribution changes simply do not rise to the level of the abuse of monopoly power.

10. \textit{The Permissibility of Vertical Integration}

Termination or nonrenewal of distributorships can take place as part of a plan for vertical integration, or can operate with the effect of partial vertical integration. Unless done by a monopolist, vertical integration is not a violation of the Sherman Act.\textsuperscript{324} The United States Supreme Court set forth that proposition in its 1948 decision, \textit{United States v. Columbia Steel Co.}:\textsuperscript{325} “It seems clear to us that vertical integration, as such without more, cannot be held violative of the Sherman Act.”\textsuperscript{326}

The Eighth Circuit has defined vertical integration as “the inclusion within a single firm of two or more stages in the production or distribution of an end product.”\textsuperscript{327} The courts have sometimes viewed vertical integration as merely a larger scale example of the manufacturer’s right to replace one exclusive distributor with another without violating section 1 of the Sherman Act.\textsuperscript{328} The Ninth Circuit has held that without “an anticompetitive intent or effect, a manufacturer may replace one exclusive distributor with another without violating § 1 of the Sherman Act, even if the change is effected by integrating vertically.”\textsuperscript{329} More recently, the Seventh Circuit engaged in a similar analysis.\textsuperscript{330} Likewise, the First Circuit has held that a decision to integrate vertically downstream\textsuperscript{331} did not violate the antitrust laws when a newspaper decided to begin selling its product directly.\textsuperscript{332}

Accordingly, a manufacturer should be free to integrate vertically in order to achieve economic efficiencies. This proposition is qualified primarily by the assumed inapplicability to any particular factual situation of the antimerger provisions of

\begin{itemize}
\item \textsuperscript{323} Mogul v. General Motors Corp., 391 F. Supp. 1305, 1314 (E.D. Pa. 1975).
\item \textsuperscript{324} See Auburn News Co. v. Providence Journal Co., 659 F.2d 273, 278 (1st Cir. 1981) (“Vertical integration by a monopolist, however, can have adverse consequences on competition because monopoly at one level of the production-distribution continuum may carry with it the ability to affect competition in earlier or later phases.”); Byars v. Bluff City News Co., 609 F.2d 843, 858–59, 861 (6th Cir. 1979) (stating three situations in which a refusal to deal as part of a vertical integration scheme is anticompetitive).
\item \textsuperscript{325} 334 U.S. 495 (1948).
\item \textsuperscript{326} Id. at 525.
\item \textsuperscript{327} Paschall v. Kansas City Star Co., 727 F.2d 692, 696 n.3 (8th Cir. 1984) (quoting Paschall v. Kansas City Star Co., 695 F.2d 322, 327 n.6 (8th Cir. 1982)). Cf. Coleman Motor Co. v. Chrysler Corp., 525 F.2d 1338, 1346–47 (3d Cir. 1975) (examining whether a reduction in intrabrand competition by a vertically integrated distribution system is unlawful, and holding that a right to structure one’s distribution system as it wishes “is at least subject to the qualification that a lawful end achieved by unlawful means is not protected from the antitrust laws.”).
\item \textsuperscript{328} See \textit{supra} text following note 250.
\item \textsuperscript{329} Crown Beverage Co. v. Cerveceria Moctezuma, S.A., 663 F.2d 886, 888 (9th Cir. 1981).
\item \textsuperscript{330} University Life Ins. Co. of Am. v. Unimarc Ltd., 699 F.2d 846, 852 (7th Cir. 1983), quoted in Jack Walters & Sons Corp. v. Morton Bldgs., Inc., 1984–2 Trade Cas. (CCH) ¶ 66,080 (7th Cir. 1984).
\item \textsuperscript{331} Auburn News Co. v. Providence Journal Co., 659 F.2d 273, 278 (1st Cir. 1981) (“In essence, applicant decided to vertically integrate downstream—that is to undertake the distribution of its products which had been and could be sold to independent producers or distributors.”).
\item \textsuperscript{332} Id.
\end{itemize}
section 7 of the Clayton Act\textsuperscript{333} and section 2 of the Sherman Act\textsuperscript{334} which proscribes monopolization and attempts and conspiracies to monopolize.

B. State Laws Applicable to Distributorships

Two typical types of statutory protection—the Uniform Commercial Code and state dealer protection acts—and several frequently tried common law theories (fiduciary duty, duty of best efforts, and a duty of good faith and fair dealing) comprise the majority of dealer claims under state law.\textsuperscript{335}

1. The Uniform Commercial Code

Several provisions of Article Two of the Uniform Commercial Code hold significance for dealer termination litigation: the provisions regarding termination and cancellation of contracts, the express obligation of good faith, and the provisions regarding unconscionability.\textsuperscript{336} However, the courts have typically held that certain provisions of the Code, especially section 2–302 concerning unconscionability, are not applicable to distribution agreements.\textsuperscript{337} Indeed, cases which support 2–302's applicability are almost impossible to find.

A number of courts have held Article Two of the U.C.C. to be applicable to distribution agreements. The Fifth Circuit in its leading opinion, \textit{Corenswet, Inc. v. Amana Refrigeration},\textsuperscript{338} directly held that the Uniform Commercial Code applies to

\textsuperscript{333} 15 U.S.C. § 18 (1984 Supp.). See University Life Ins. Co. of Am. v. Unimarc Ltd., 699 F.2d 846, 852 (7th Cir. 1983). A section 7 claim can be difficult to support. Sierra Wine & Liquors Co. v. Heublein, Inc., 626 F.2d 130, 133 (9th Cir. 1980) (affirming summary judgment for defendant on a terminated distributor's section 7 claim, where the defendant corporation acquired control of the parent of the company for which plaintiff was the exclusive distributor, and the acquired company then terminated the distributor agreement).


\textsuperscript{335} The state of Massachusetts is a typical example of a state in which a number of statutes as well as the common law are available for a terminated dealer to attempt to use in litigation with the manufacturer. There are at least three statutes potentially available in Massachusetts; Article Two of the Uniform Commercial Code, \textit{M.A.S.S. GEN. LAWS} ch. 105, § 2–101 to 2–725 (1985); the Massachusetts State Antitrust statute, \textit{M.A.S.S. GEN. LAWS} ch. 93A, §§ 4–6 (1985); and the Massachusetts Unfair and Deceptive Trade Practices statute, \textit{M.A.S.S. GEN. LAWS} ch. 93A § 2 (1985). The leading Massachusetts termination case is \textit{Zapatha v. Dairy Mart}, 381 Mass. 287, 408 N.E.2d 1370 (1980), which reversed a judgment in favor of franchisees who sought to enjoin termination of a franchise agreement. Under both the UCC and the Massachusetts Deceptive Trade Practices statute, the appellate court held that it was not unconscionable, in bad faith, nor an unfair or deceptive act or practice for the franchisor to enforce a franchise provision that permitted termination without cause, when the franchisor had given written notice to the franchisee that the contract was being terminated effective in ninety days. \textit{Id.} at 293, 295, 408 N.E.2d 1370, 1373, 1376–77.

\textsuperscript{336} See generally Comment, \textit{Article Two of the Uniform Commercial Code and Franchise Distribution Agreements}, 1969 Duk\textit{e L.J.} 959, 1009 (There is no adequate reason that the relationships between franchised dealers and their manufacturers "should not be governed by the modern commercial principles of the Code whenever they are appropriate.").

\textsuperscript{337} Stanley A. Klopp, Inc. v. John Deere Co., 510 F. Supp. 807 (E.D. Pa. 1981), aff'd mem., 676 F.2d 688 (3d Cir. 1982) (defendant manufacturer's motion for partial summary judgment properly granted in a suit by a former dealer); \textit{Zapatha v. Dairy Mart}, 381 Mass. 284, 287, 408 N.E.2d 1370, 1375–76 (1980) (a ninety day termination clause in a franchise agreement was not unconscionable under section 2–302; the issue was a question of law for the court, to be determined as of the time the contract was made); \textit{W.L. May, Co. v. Pâlisco-Ford Corp.}, 273 Or. 701, 543 P.2d 283 (1975) (reversing judgment for damages obtained by a wholesale parts distributor that sued the manufacturer for termination of a distributorship contract). \textit{See generally} Gellhorn, \textit{Limitations on Contract Termination Rights—Franchise Cancellations}, 1967 Duk\textit{e L.J.} 465, 492 ("In any case, the doctrine of unconscionability has not generally been applied to limit the harsh effects of franchise terminations.").

\textsuperscript{338} 594 F.2d 129 (5th Cir.), cert. denied, 444 U.S. 938 (1979).
The court reversed the grant of a preliminary injunction which forbade the termination of an exclusive distributor of home appliances, holding that an arbitrary termination was permissible under the contract and under the Uniform Commercial Code. The trial court had ruled (a) that the arbitrary termination was a breach of the distributorship agreement; (b) that the termination clause, which permitted either party to terminate the contract "for any reason," permitted termination for some reason and not for no reason; and (c) in the alternative, that the U.C.C.'s "good faith" principle forbade the bad faith termination of exclusive distributorships. Before analyzing the obligation of good faith dealing and the effect of the Uniform Commercial Code's provision regarding duration of an agreement, the court held that the Uniform Commercial Code governs a distributorship agreement. Numerous courts have agreed.

Two decisions in the Eighth Circuit have expressly followed Corenswejt applying both Iowa and Missouri law. The Sixth Circuit also followed Corenswejt in Cardinal Stone Co. v. Rival Manufacturing Co., which affirmed a grant of summary judgment in favor of a defendant manufacturer under Ohio law, holding that an experienced businessman may not represent himself "as an untutored victim of sharp business practices." It is worth noting that Cardinal Stone affirmed summary judgment regarding the right to terminate a contract. Application of the Uniform Commercial Code to distributorship agreements may encourage summary disposition of questions under distributorship agreements. In a case handled by the author, Mead Corp. v. McNally-Pittsburg Manufacturing Corp., the Sixth Circuit Court of Appeals pointed out that the U.C.C. provides rules of law to resolve questions which might otherwise remain for jury consideration.

Kirby v. Chrysler Corp. noted that "a clear majority of courts that have reached the issue have held that distributorship or franchise agreements are governed by" the U.C.C. The courts that have so held include the Fifth,

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339. Id. at 134. The Fifth Circuit continues to adhere to Corenswejt. Acme Refrigeration v. Whirlpool Corp., 747 F.2d 292, 293 (5th Cir. 1984).
341. Id. at 133.
342. Id. at 134–35.
343. See, e.g., Aaron E. Levine & Co. v. Calkraft Paper Co., 429 F. Supp. 1039, 1048 (E.D. Mich. 1976) ("Since the complaint involves a transaction in goods, the sales article of Uniform Commercial Code as adopted in Michigan is applicable."); Des Moines Blue Ribbon Distribs. v. Drewrys Ltd., 129 N.W.2d 731, 736 (Iowa 1964) ("A distributorship contract is more than a mere contract of agency. It is also a sales contract but it is also more than a mere sales contract. It partakes of the substantial aspects of both."); Quality Performance Lines v. Yoho Automotive, 609 P.2d 1340, 1342 (Utah 1980) ("Although a distributorship agreement is more involved than a typical sales contract, it is subject to Utah's Uniform Commercial Code.").
345. 669 F.2d 395 (6th Cir. 1982).
346. Id. at 396.
347. 654 F.2d 1197 (6th Cir. 1981).
348. Id. at 1206. Accord WICO Corp. v. Willis Indus., 567 F. Supp. 352, 355 (N.D. Ill. 1983) ("Although the Agreements are in many ways hybrids, their sale-of-goods purpose clearly predominates.").
350. Id. at 749.
Sixth, and Seventh, and Eighth Circuits.

Another line of cases holds that even though the Uniform Commercial Code may not be expressly applicable to distribution agreements, its principles are applicable by analogy. Zapatha v. Dairy Mart reversed an injunction against termination of a franchise agreement, holding that the principles of unconscionability and good faith embodied in the Uniform Commercial Code applied to the agreement, but that the franchisor’s termination of the agreement without cause on ninety days’ notice was neither unconscionable nor in bad faith under such standards. In so holding, the court analyzed whether the sales article of the U.C.C. applied to the agreement in question, and concluded that its principles of good faith and unconscionability applied to franchise agreements by analogy. A similar analysis was followed in Stanley A. Klopp, Inc. v. John Deere, which upheld the enforcement of a no-lost-profits provision in a dealer agreement.

2. State Dealer Protection Statutes: The Wisconsin Fair Dealership Law

Many states have enacted dealer protection acts of various types. An analysis of each is beyond the scope of this Article. Most cases brought under these statutes are controlled by the language of the applicable legislation, so that their precedential effect is limited. Courts have often relied upon the presence or absence of state dealer protection statutes to determine the public policy of a particular state toward dealers or franchisees. Nevertheless, the absence of legislation is a thin ground upon which to base a determination of policy. State contract and tort law should govern, with perhaps the passing observation that the legislature has not acted in the area.


353. Rockwell Eng’g Co. v. Automatic Timing & Controls Co., 559 F.2d 460, 463 (7th Cir. 1977).

354. Ralph’s Distrib. Co. v. AMF, Inc., 607 F.2d 570, 573 n.6 (8th Cir. 1981) (Iowa law); Vigano v. Wybain, Inc., 633 F.2d 522, 525 n.3 (8th Cir. 1980) (Missouri law).

355. 381 Mass. 284, 287, 408 N.E.2d 1370, 1374-75 (1980) ("Accordingly, courts have applied the Uniform Commercial Code to distributorship agreements even though such agreements have concerned more than the sale of goods.").

356. Id. at 288-94, 408 N.E.2d at 1374-77.


358. These statutes are compiled in CCH Bus. FRANCH. GUIDE.

359. Luis Rosario, Inc. v. Amana Refrigeration, 733 F.2d 172, 173 (1st Cir. 1984) (public policy of Puerto Rico Dealer’s Act was to prevent dealer termination without just cause); Arnott v. American Oil Co., 609 F.2d 873, 883 (8th Cir. 1979) (South Dakota Franchise Act was indicative of public policy regarding franchise terminations), cert. denied, 446 U.S. 918 (1980); 33 Flavors, Inc. v. Bresler’s 33 Flavors, 475 F. Supp. 217, 227 n.29 (D. Del. 1979) ("The Delaware courts have recognized the Franchise Act as being an expression of the public policy of the State of Delaware."); Atlantic Richfield Co. v. Razumic, 480 Pa. 366, 390 A.2d 736 (1978) (relying in part on public policy shown by dealer termination law which had not yet taken effect).

360. Bain v. Champlin Petroleum Co., 692 F.2d 43, 48 (8th Cir. 1982) (distinguishing Arnott v. American Oil Co., 609 F.2d 873 (8th Cir. 1979), cert. denied, 446 U.S. 918 (1980), which had relied upon South Dakota Franchise Act, because Missouri had no comparable statute); Mobil Oil Corp. v. Rubenfeld, 48 A.D. 2d 428, 370 N.Y.S.2d 943, 949 (App. Div. 1975) (in reversing a trial court’s determination that a fiduciary relationship existed between a dealer and an oil company, the court noted that the New York legislature had passed a franchise statute which was vetoed by the governor; the court concluded that there was no fiduciary duty with respect to franchise terminations), discussed in Arnott v. American Oil Co., 609 F.2d 873, 883 n.8 (8th Cir. 1979), cert. denied, 446 U.S. 918 (1980).
No state dealer protection act places more restrictive conditions upon a manufacturer's conduct than the Wisconsin Fair Dealership Law.\(^{361}\) The statute has broad applicability to agreements between manufacturers and dealers and stringent requirements with respect to changes in the competitive circumstances of a dealership and with respect to termination. An examination of the cases decided under the Wisconsin Act reveals the length to which state laws can go to protect distributors.

Assuming that the prospective distributor meets the requirement of possession of a "dealership,"\(^{362}\) the following summary of the Wisconsin Fair Dealership Law shows the extensive protections the act affords dealers. First, the manufacturer may not terminate, cancel, fail to renew, or substantially change the competitive circumstances of a dealership agreement without good cause. The burden of proving good cause falls on the manufacturer.\(^{363}\) In addition, the statute requires at least ninety days' prior written notice of termination, cancellation, nonrenewal, or substantial change in competitive circumstances. The notice must state all the reasons for such action, and must provide the dealer sixty days within which to correct any claimed deficiency.\(^{364}\) In the event of termination, the dealer has the right to require repurchase at the fair wholesale market value all inventories bearing the manufacturer's trademark or other identification sold to the dealer for resale.\(^{365}\)

The Wisconsin Fair Dealership Law also affects the relief available to a terminated dealer. The act grants a right of action for both damages (together with costs and "reasonable actual attorney fees") and injunctive relief against termination, cancellation, nonrenewal, or substantial change of competitive circumstances in violation of the statute.\(^{366}\) The statute also purports to invalidate arbitration agreements in which the criteria for determination of good cause and the relief provided are less substantial than the act provides.\(^{367}\) The statute defines "good cause" as either the dealer's lack of substantial compliance with essential, reasonable, non-


\(^{363}\) Wis. Stat. Ann. § 135.03 (West 1984). Van v. Mobil Oil Corp., 515 F. Supp. 487, 490–91 (E.D. Wis. 1981) (a substantial change in the competitive circumstances of a dealership agreement within section 135.03 occurred when the manufacturer changed a dealer's credit terms to COD, even though the change came after plaintiff issued a check to defendant and the check was later returned to defendant marked "non-sufficient funds.").

\(^{364}\) Wis. Stat. Ann. § 135.04 (West 1984). Violation of this section is sufficient to warrant the grant of injunctive relief. In Paul Reilly Co. v. Dynaforce Corp., 499 F. Supp. 1033 (E.D. Wis. 1978), the court granted a preliminary injunction against a termination that did not meet the notice requirements of the statute.


\(^{367}\) Wis. Stat. Ann. § 135.05 (West 1984). Cutter v. Scott & Fetzer Co., 510 F. Supp. 905, 907–09 (E.D. Wis. 1981) held that the general policy in favor of forum selection clauses must yield to the Wisconsin statutory policy favoring the right to maintain an action in court under this statute. However, a case involving a forum selection provision like Cutter should be distinguished from a case involving an arbitration agreement. Under the United States Arbitration Act, 9 U.S.C. §§ 1–208 (1983), the strong federal policy favoring the enforcement of arbitration agreements should prevail over a contrary Wisconsin policy. Southland Corp. v. Keating, 465 U.S. 1 (1984) held that a provision of the California Franchise Investment Law (which had been interpreted by the California Supreme Court to require judicial consideration of claims under that state statute) must give way to the federal arbitration statute. A similar outcome should result when a party seeks to invalidate an arbitration provision in a dealer agreement under the Wisconsin statute.
discriminatory requirements, or the dealer's bad faith in carrying out the terms of the dealership.368

The Wisconsin act is broad in scope. It applies to agreements "either expressed or implied, whether oral or written,"369 and the courts interpret it broadly. Indeed, one element of a "dealership" under the statute is "a community of interest in the business" of distribution.370 One appellate court has held that the typical performance standards in a dealer agreement are a sufficient indication of the manufacturer's "community of interest" with the dealer in the business.371 Another court has construed the act broadly, implying a dealer agreement outside the written dealer agreement.372 However, either problems of contract formation373 or a plaintiff's status as a manufacturer's representative374 may avoid the act's application.

Courts have readily granted injunctive relief and damages under the Wisconsin Fair Dealership Law.375 However, one court has held that despite the fact that the Wisconsin statute applies even to statewide terminations of all of a manufacturer's dealers, permanent injunctive relief would not be granted when the manufacturer had abandoned its dealer system in every other state. Instead, the plaintiff was deemed to have a remedy in damages.376 The Fifth Circuit opinion in C.A. May Marine Supply Co. v. Brunswick Corp.,377 affirming the award of damages of one year's lost profits under this statute, contains one of the best discussions on damages in a terminated dealer action. The court set forth the generally accepted methods of calculating damages.378 The court also noted that similar conduct frequently underlies alleged violation of both franchise laws and antitrust laws.379

The Wisconsin act's standards import into distributorship agreements a far more stringent set of requirements than is usually contained in a dealer agreement prepared by a manufacturer. However, the selection of the law of another state, coupled with

372. Van v. Mobil Oil Corp., 515 F. Supp. 487, 491 (E.D. Wis. 1981). In Van, the "plaintiff and defendant executed a retail dealer's contract under the terms of which plaintiff became a Mobil dealer." Id. at 489. Yet, under section 135.02, the court found an implied agreement to deliver to plaintiff gasoline on a previous load basis system, to be a change in the parties' dealer agreement. Id. at 491. In effect, the court implied a dealer agreement outside the written dealer contract.
373. Century Hardware Corp. v. Acme United Corp., 467 F. Supp. 350, 354 (E.D. Wis. 1979) (finding no dealer agreement because defendant's form of agreement specified the terms of acceptance, with which plaintiff did not comply).
374. Compare Wilburn v. Jack Cartwright, Inc., 543 F. Supp. 174, 178 (E.D. Wis. 1982) ("manufacturer's representative" was a dealer within the statute; defendant permanently enjoined from terminating plaintiff without first complying with statute), with Quirk v. Atlanta Stove Works, 537 F. Supp. 907 (E.D. Wis. 1982) (manufacturer's sales representative was outside protection of Fair Dealership Law; summary judgment granted defendant on statutory claim).
375. Menominee Rubber Co. v. Gould, Inc., 657 F.2d 164 (7th Cir. 1981) (affirming grant of preliminary injunction against termination under Wisconsin statute); Reinders Bros. v. Rain Bird E. Sales Corp., 627 F.2d 44 (7th Cir. 1980) (affirming preliminary injunction for terminated dealer in view of the irreparable harm to the good will accumulated during twenty years as a dealer for defendant, but reversing trial court's action in failing to consider defendant's demand for a bond under Fed. R. Civ. P. 65(c)).
378. Id. at 1053.
379. Id. at 1053 n.4.
an arbitration provision, should enable a manufacturer to avoid the application of that statute.

3. Implying a Fiduciary Relationship in Dealership Agreements

In the 1970s, a body of commentary and a few cases argued for the imposition of an implicit fiduciary relationship in franchise agreements. Generally, this notion is unsupported by the case law. Traditionally, courts imposed no fiduciary relationship upon the contractual relationship existing between a distributor and a manufacturer. However, the fiduciary relationship theory reached its high water mark in Arnott v. American Oil Co., an action by a service station dealer alleging that the defendant oil company breached its fiduciary duty by terminating his lease without good cause. The Eighth Circuit used vague language to describe the existence of an "inherent" fiduciary duty. Subsequent cases have severely restricted the vitality of Arnott. The Eighth Circuit itself expressly limited Arnott in Bain v. Champlin Petroleum Co. and lower courts have refused to give Arnott a broad reading.

Two other circuits have also criticized the result in Arnott. The Fifth Circuit, in Carter Equipment Co. v. John Deere Industrial Equipment Co., reversed a $1 million jury verdict "based primarily on [a] cause of action that alleged a breach


382. Brown, Franchising—A Fiduciary Relationship, 49 Tex. L. Rev. 650, 664 (1970–1971) ("I immediately concede that no reported American case has applied these theories to franchising. . . ."). In re 7–11 Franchise Antitrust Litig., 1974–2 Trade Cas. (CCH) ¶ 75,429 at p. 98,428 (N.D. Cal. 1974) ("Neither party cites any reported federal court cases recognizing a concept of fiduciary duty in the franchising area, and this Court does not see anything to be gained by adopting this concept that could not be gained by using other concepts long accepted in the law."). Eaton, Yale and Towne, Inc. v. Sherman Indus. Equip. Co., 316 F. Supp. 435, 445 (E.D. Mo. 1970) ("The Court has been cited no authority that indicates the existence of a franchisor-franchisee relationship that places the franchisor in the position of a fiduciary."); Texaco, Inc. v. A.A. Gold, Inc., 78 Misc. 2d 1050, 357 N.Y.S.2d 951, 956 (Sup. Ct. 1974) ("The syllogistic semantics" of such a theory are unjustified and "[t]he court in this case will not indulge itself in such fantasies."). See American Nursing Care v. Leisure, 609 F. Supp. 419, 431 (N.D. Ohio 1984).

383. A.B.C. Packard, Inc. v. General Motors Corp., 275 F.2d 65, 69 (9th Cir. 1960) (in the absence of fraud or special contractual provisions, existence of economic inequality in distributorships "does not create a legal fiduciary relationship between the contracting parties."); Motor Car Supply Co. v. General Household Util. Co., 80 F.2d 167, 171 (4th Cir. 1935) (distribution for refrigerators in which the plaintiff had argued that it was a "comparatively helpless dealer at the mercy of manufacturer"); the court replied that when "parties dealt upon such a basis, however, they cannot invoke the aid of the courts when their expectations are disappointed. Our function is to interpret and enforce contracts, not to make or extend them.").

384. 609 F.2d 873, 881 (8th Cir. 1980), cert. denied, 446 U.S. 918 (1980).

385. Id. at 881.


387. RJM Sales & Mktg. v. Banfi Prods. Corp., 546 F. Supp. 1368, 1378 (D. Minn. 1982) (granting motion for summary judgment on a fiduciary relationship claim and explaining that Bain had "reconsidered Arnott."); Picture Lake Campground v. Holiday Inns, 497 F. Supp. 858, 869 (E.D. Va. 1980) (criticizing Arnott, and noting that "Arnott is in the distinct minority of federal and state court decisions which have either rejected or failed to find the existence of a fiduciary duty in the franchise context.").
of a fiduciary duty,"389 remanding for a new trial under correct jury instructions. The court specifically disagreed with the Eighth Circuit’s statement that a fiduciary duty inheres in a franchise relationship,390 and further held Arnott distinguishable.391 The Seventh Circuit in Murphy v. White Hen Pantry Co.392 not only limited Arnott to a franchise termination situation, but also noted that "an inspection of the jury instruction upheld there indicates that nothing more than well-accepted contract principles were thereby imposed."393

Murphy v. White Hen Pantry Co.394 summarized the cases opposing the fiduciary relationship theory without reference to its earlier opinion in Bromberg v. Holiday Inns of America.395 The Seventh Circuit held in White Hen Pantry that no fiduciary duty to convenience food store franchisees was owed in a case for "damages, declaratory and injunctive relief, reformation of the franchise contracts, and an accounting."396 The court reviewed the cases involving attempts by plaintiffs to imply fiduciary duties into franchise agreements, holding that the case law did not support such a theory.397 Since the case law has not embraced fiduciary theories, a claim based on fiduciary duty is not likely to survive a preliminary motion.398

4. Implied Covenants of Good Faith and Fair Dealing

Unable to state a claim for breach of an implied fiduciary duty, a terminated dealer may instead pursue relief under the theory that implied in every agreement is a covenant of good faith and fair dealing which precludes either party to the agreement from taking actions to frustrate the benefits to the other party under the agreement.399

389. Id. at 389 n.4. However, the court held that it was not error to submit this cause of action to the jury; the only error was in the jury instructions. Id. at 392.
390. Id. at 390 n.6.
391. Id. at 391 n.8.
393. Id. at 355.
394. 691 F.2d 350, 354-55 (7th Cir. 1982).
395. 388 F.2d 639, 645-46 (7th Cir. 1967) (no joint venture created by franchisor's commitment letter proposing to accept plaintiff's application for hotel franchise upon compliance with specific conditions; court rejected argument that the letter created a fiduciary relationship), cert. denied, 391 U.S. 912 (1968).
396. 691 F.2d 350, 351 (7th Cir. 1982).
397. Id. at 354-55. Accord Jack Walters & Sons Corp. v. Morton Bldgs., 737 F.2d 698, 711 (7th Cir. 1984); Doned Stadium Hotel v. Holiday Inns, 732 F.2d 480, 485 (5th Cir. 1984) (no breach of a fiduciary relationship when franchisor acquired hotel in franchisee's area); Picture Lake Campground v. Holiday Inns, 497 F. Supp. 858, 869 (E.D. Va. 1980) ("A franchise relationship is inherently a business relationship, not a fiduciary relationship.").
398. In Ohio and California, the courts have expressly rejected the implication of a fiduciary relationship in distribution agreements. See Walker v. KFC Corp., 728 F.2d 1215, 1221 n.5 (9th Cir. 1984) (in fast food franchisee's suit for damages against franchisor, court held trial court properly directed a verdict against plaintiff's claim for breach of fiduciary duty because no such duty existed between the parties either under California common law or under California Franchise Investment Law); Stanley Steemer Int'l v. Frazier, 2 Ohio Bar Rpt. 443, 447 (Pickaway County C.P. 1982) (sale of franchise created no fiduciary relationship under Ohio law), aff'd, 57 Ohio St. Bar Ass'n Rpt. 883 (App. 1984); Dayton Motels v. Holiday Inns, No. 74-1150 (Montgomery County C.P., July 29, 1977) (briefed by author; court rejected fiduciary duty as part of a franchise in an action in which the plaintiff maintained that the defendant franchisor owned a fiduciary duty which was breached by the addition of another motel into plaintiff's allegedly exclusive territory). But cf. McAlpine v. AAMCO Automatic Transmissions, 461 F. Supp. 1232, 1249 (E.D. Mich. 1978) ("There is case law for the proposition that a franchisor who adds franchisees to an already saturated market without utilizing geographic spacing provisions has engaged in tortious conduct.").
399. See generally Burton, Breach of Contract and the Common Law Duty to Perform in Good Faith, 94 Harv. L.
In the distributorship area, a number of cases have held that a dealer may rely upon an implied obligation of good faith and fair dealing.\footnote{400} In most instances, this implied obligation means no more than a duty "not to hinder . . . [one's] ability to achieve operational success."\footnote{401} The implication of covenants in dealer agreements is subject to the general rule that no implied covenant or duty will be found that is inconsistent with the express terms of the agreement.\footnote{402} As stated by the Fifth Circuit, the implied obligation of good faith "should not be used to override or contradict" the express terms of a contract.\footnote{403}

Further, the courts can usually reach an equitable result without expressly imposing a duty of good faith and fair dealing. The Court of Appeals for the District of Columbia provided a good example of this point in an opinion which examined the existence and applicability of a "duty to perform in good faith" in an action brought by a terminated sales representative.\footnote{404} The court held that "the modern doctrine of 'obligation to perform in good faith' [is] . . . simply a rechristening of fundamental principles of contract law well established" in the cases, and that the significance of

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\footnote{400. lippo v. Mobil Oil Corp., 776 F.2d 706, 714 n.14 (7th Cir. 1985) (implied covenants of good faith "restricts franchisor discretion in terminating a franchise agreement to those cases in which good cause exists."); United Roasters v. Colgate-Palmolive Co., 649 F.2d 985, 990 (4th Cir.) ("Clearly it had an obligation of good faith performance up until its right of termination was actually effective."); cert. denied, 454 U.S. 1054 (1981); 33 Flavors, Inc. v. Bresler's 33 Flavors, 475 F. Supp. 217, 320 (D. Del. 1979) (implying a duty of good faith under a franchise license agreement); W.L. May Co. v. Philco-Ford Corp., 273 Or. 701, 543 P.2d 283, 288 (1975) ("However, proof that the manner in which the repurchase election was exercised at the time of termination amounted to a breach of Philco's implied obligation of good faith and fair dealing would have been an independent basis for a recovery of damages."). Accord, Contemporary Mission v. Famous Music Corp., 557 F.2d 918, 923 n.8 (2d Cir. 1977) ("Under New York law there is implied in every contract a covenant of fair dealing and good faith"); the defendant's 'determination of [the] effectiveness or profitability of promotion [of a product to be distributed has] to be made in good faith."). Cf. Reprosystem, B.V. v. SCM Corp., 727 F.2d 257, 264 (2d Cir. 1984) (recognizing that under New York law in some circumstances a party to a contract may be bound by an implied agreement or duty to negotiate in good faith to reach an agreement), cert. denied, 105 S. Ct. 110 (1984).}
the doctrine is in the implication of terms into the agreement between the parties.405 The court also agreed that the concept of good faith in the performance of contracts is an "excluder," serving simply to exclude a wide range of conduct said to constitute bad faith.406 The court then summarized the doctrine of good faith performance of contracts as the courts apply it, contrasting good faith performance with traditional contract analysis.407 The Fourth Circuit has also dealt with this issue and identified those situations in which the covenant should and should not be implied. In "an ordinary breach of contract claim . . . in which the economic losses are compensable under traditional contract principles, the reason for the emerging principle is simply not present . . . ."408

Even the commentators who support additional obligations running from the manufacturer to the distributor have recognized that few cases support the implied covenants409 and numerous cases have rejected them. Most of these cases do so not in broad terms, but instead reject the implication of various obligations said to flow from a general duty of good faith and fair dealing. For example, courts have refused to imply a covenant not to compete in a licensee's motel market.410 Courts have also rejected the argument that nonrenewal of a distributor agreement in bad faith and in violation of both the Sherman Act and the Dealer's Day in Court Act was a breach of an implied covenant of good faith.411 Further, courts have rejected an implied obligation on the part of a franchisor not to acquire a hotel in the territory of its franchisee412 and have rejected the implication of a common-law duty to maintain a valuable franchise and not to terminate a distributorship contract.413 Finally, courts have rejected an implied covenant to repurchase merchandise in an action by a wholesaler against the manufacturer for termination of a distributorship.414 No doubt this reluctance to imply various obligations when the parties' relationship is governed by a written distributorship agreement flows from the fact that commercial parties can be expected to state their agreement with clarity and from the policy that too free an implication of duties will leave the parties' relationship in a state of uncertainty, neither party knowing exactly what duties it may later be found to have assumed.415

405. Id. at 1152.
406. Id.
407. Id. at 1152-54.
408. United Roasters v. Colgate-Palmolive Co., 649 F.2d 985, 990 (4th Cir. 1981). Accord Triangle Mining Co. v. Stauffer Chem. Co., 753 F.2d 734 (9th Cir. 1985) (discretionary power to terminate held not subject to implied covenant of good faith; motive of terminating party is irrelevant).
409. H. Brown, Franchising—Realities and Remedies 126 (1973) ("Very few cases have found implied covenants for franchisees with regard to actual practices, apart from the contract."); Brown, Franchising—A Fiduciary Relationship, 49 Tex. L. Rev. 650, 666 (1970-1971) (acknowledging "the standard common-law view that no good faith obligation exists in the performance of a contract.").
At least one case, however, has excused compliance with the termination provisions of the agreement based upon a finding that the agreement "was subject to an implied condition that if, without fault of the parties, the ... market [that existed at the time of execution of the agreement] ceased to be available ... [then] the [a]greement would be dissolved and the parties excused from performing it."416

In summary, in a distributorship situation an implied covenant should be found only when absolutely necessary, and only when the implied term is not inconsistent with any provision of the written dealership agreement. Moreover, the same result can usually be reached applying other principles of contract interpretation.

5. The Best Efforts Obligation

Both the manufacturer and its distributor frequently argue that the other has an obligation to use its best efforts to promote distribution of the product. Justice Cardozo, in the leading case, Wood v. Lucy, Lady Duff-Gordon,417 implied a promise to use "reasonable efforts"418 in a contract of exclusive agency. In that case the defendant, a creator of fashions, granted to plaintiff the exclusive right for one year to place her endorsements on the designs of others, to place her own designs on sale, or to license others to market them. The court held that the plaintiff was under an implied obligation to use reasonable efforts to market the defendant's designs.

Twice in recent years the Second Circuit has had occasion to consider the doctrine of Wood v. Lucy, Lady Duff-Gordon. In Contemporary Mission v. Famous Music Corp.,419 the Court of Appeals refused to disturb a jury verdict that a producer and distributor of musical recordings failed to promote sufficiently a rock opera, holding that the obligation to use reasonable efforts to promote the production "could not be satisfied merely by technical compliance with the spending and appointment requirements of [the agreement]." More recently the Second Circuit has commented upon the surprising absence of authority on the meaning of a best efforts obligation, and contrasted the situation before it with that found in Contemporary Mission. In Zilg v. Prentice-Hall, Inc.,420 the Second Circuit held that a publisher did not have an obligation to use its best efforts to promote a book, but had an implied obligation to use good faith to promote the book, and had met that duty. The court's analysis of the best efforts problem shows that the language of a particular agreement is highly significant in determining whether such an obligation will be found to exist.421

416. Beltronics, Inc. v. Eberline Instrument Corp., 369 F. Supp. 295, 302 (D. Colo. 1973), aff'd, 509 F.2d 1316 (10th Cir. 1974), cert. denied, 421 U.S. 1000 (1975). In this case, the defendants "did not comply with the termination provisions of paragraph 16a of the Agreement, which provided for termination prior to the expiration of the ten-year term of the Agreement upon ninety days notice and payment to Beltronics of $75,000.00." Id. at 299. However, through no fault of the defendants the market disappeared, so that the defendants were not required to comply with that section of the agreement "and their failure to do so [did] not constitute an actionable breach of the Agreement." Id. at 302.

417. 222 N.Y. 88, 118 N.E. 214 (1917).

418. Although customarily called a "best efforts" concept, Justice Cardozo twice characterized the implied obligation as one of the use of "reasonable efforts." Id. at 89, 118 N.E. at 215.

419. 557 F.2d 918, 923-24 (2d Cir. 1977).


421. Id. at 679. However, where a contract for promotion of a food product expressly obligated the defendant to use its best efforts in the promotion of the item, and instead the defendant simply ceased performance, "it broke its contract when it terminated its performance." United Roasters v. Colgate-Palmolive Co., 649 F.2d 985, 990 (4th Cir. 1981).
Because many distribution agreements contain language that requires the dealer to promote the product, the specific language of the agreement is very important.

Perhaps the most significant best efforts litigation in a distributorship situation is found in Bloor v. Falstaff Brewing Corp. In that action, the Second Circuit affirmed a judgment against a defendant brewer in an action for damages arising from the defendant’s discontinuance of certain brands or its failure to use best efforts in their promotion and for its failure to make certain royalty payments. Following a bench trial, the district court held that the defendant brewer had failed to use its best efforts to merchandise the products. That court construed the term “best efforts” to be the good faith efforts of the average, prudent, comparable party. The trial court found that the discontinuance of the establishment of sales goals (“an essential step in any marketing effort”) did not constitute the “best efforts” of the company. Finally, the court held the measure of damages for breach of a best efforts obligation to be “the amount necessary to put the injured party in the exact position he would have been if the contract had not been breached.”

The Second Circuit agreed with the trial court’s “excellent opinion,” recognizing that “New York law is far from clear” as to how onerous an obligation is imposed by a best efforts agreement. Nevertheless, the result in the case turned upon the language of the best efforts agreement. The Second Circuit stated that although “management was entirely free to exercise its business judgment concerning the maximization of profits for other brands, it had relinquished this freedom...
when it agreed to the "'added obligation to use 'best efforts to promote and maintain a high volume of sales . . . ."'432

The prudent manufacturer should include in a distribution agreement some form of defined obligation, depending upon the particular circumstances of the parties and the industry involved. This obligation serves to satisfy the need for a strong network of distributors.

6. Tortious Interference Claims

Terminated dealers frequently add a claim for tortious interference with a contract or with prospective economic advantage to their bag of claims. Most courts have rejected these claims, frequently by granting defendant's motion for summary judgment.433 Plaintiffs find it difficult to maintain tort claims in the face of a detailed, written distribution agreement. These claims are usually a transparent attempt to avoid the contractual terms to which the parties agreed.

C. Adequate Grounds for Termination

Most distribution agreements specify the bases upon which they may be terminated. This section, however, discusses three reasons sufficient to support dealer terminations under both the antitrust laws and state law: termination for poor performance, for material breach, and for dishonest practices. The section then

432. Id. at 614 (quoting Wood v. Lady Duff-Gordon, 222 N.Y. 88, 118 N.E. 214 (1917)) (emphasis omitted).
433. Motive Parts Warehouse v. Facet Enters., 774 F.2d 380 (10th Cir. 1985) (affirming directed verdict on intentional infliction of economic harm; malicious interference with contract or business relationships); Camfield Tires v. Michelin Tire Corp., 719 F.2d 1361, 1367 (8th Cir. 1983) (affirming grant of summary judgment to defendant manufacturer on dealer's claim of tortious interference in its business relationship with customer); General Business Sys. v. North Am. Phillips Corp., 699 F.2d 965, 981-83 (9th Cir. 1983) (affirming summary judgment against manufacturer's claim that distributor was liable for tortious interference and abuse of process); Carlson Mach. Tools v. American Tool, 678 F.2d 1253, 1263-64 (5th Cir. 1982) (summary judgment properly granted on dealer's claim of tortious interference); Cowley v. Braden Indus., 613 F.2d 751, 754 n.1 (9th Cir.) (under Arizona law, no tortious interference with contract or with prospective business advantage), cert. denied, 446 U.S. 965 (1980); Sierra Wine & Liquor Co. v. Heublein, Inc., 626 F.2d 129, 132-33 (9th Cir. 1980) (action by a terminated wine distributor that had oral distribution agreement, and that claimed tortious inducement of transfer of wine distributorship to a new distributor, court affirmed summary judgment on tortious interference claims); Industrial Equip. Co. v. Emerson Elec. Co., 554 F.2d 276, 288-89 (6th Cir. 1978) (affirmed grant of directed verdict in favor of defendant manufacturer on tort claims for interference with contractual and economic relations and for libel); First Flight Assocs. v. Professional Golf Co., 527 F.2d 931, 936 (6th Cir. 1975) (defendant's communication with sublicensee of trademark advising it both of trademark ownership deficiencies and of sales representative's lack of authority to bind defendant did not constitute unlawful interference with or inducement to breach contract); Frank Coulson, Inc. v. General Motors Corp., 488 F.2d 202, 206-07 (5th Cir. 1974) (reversing judgment n.o.v. that had been granted in favor of the defendant, involving the manufacturer's limited privilege to intervene in contractual negotiations under Florida law); DePalma v. Jersey Shore Medical Center, 1984-1 Trade Cas. (CCH) ¶ 66,005 (D.N.J. 1984) (restating the allegations of an antitrust complaint with the additional claim of intentional and malicious action did not set forth an independent tort claim for punitive damages); Moffat v. Lane Co., 1984-2 Trade Cas. (CCH) ¶ 66,110 (D. Mass. 1984) (granting summary judgment to defendant manufacturer on interference with advantageous relation claim); Bunch v. Artec Int'l Corp., 559 F. Supp. 961, 967-69 (S.D.N.Y. 1983) (after bench trial, plaintiff failed to recover damages on claims for antitrust, breach of contract, and tortious inducement of breach of exclusive sales agreement); Glasofer Motors v. Osterlund, Inc., 180 N.J. Super. 6, 433 A.2d 780 (App. Div. 1981) (in dealer's suit, affirmed grant of summary judgment for defendants on claim of tortious interference with contractual relations). These cases make it plain that even though a claim for tortious interference with contract is frequently added to a terminated dealer action in District Court, often as a pendent claim to an antitrust claim, only rarely does a dealer recover on such a claim. Indeed, competition can be a privilege which defeats an intentional interference claim. Conoco, Inc. v. Inman Oil Co., 774 F.2d 895, 906-07 (8th Cir. 1985).
examines whether the manufacturer can later defend its termination decision upon a ground neither known at the time the decision was made nor communicated to the dealer.

1. Documented Poor Performance

In most if not all terminated dealer cases, the defendant manufacturer argues that poor performance was the real and sufficient reason for the termination or nonrenewal decision. The cases recognize that poor performance is sufficient ground to support termination.\(^4\) This section is but a brief summary of the possible grounds upon which terminations may be legitimately supported; of course documentation aids in proving the case.

Sufficient grounds to support termination include the following: the dealer’s failure to pay its account in accordance with the distribution agreement,\(^5\) the dealer’s poor sales performance,\(^6\) the dealer’s decision to take on a line of competing products or to focus its efforts upon the sale of competing products,\(^7\) and the dealer’s refusal to sign a revised form of distributorship agreement.\(^8\) Courts have also upheld

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434. See, e.g., Romey v. OK Tire & Rubber Co., 1980-2 Trade Cas. (CCH) ¶ 63,360 (D. Idaho 1980) (granting summary judgment for defendant rubber company in antitrust action by terminated tire distributor, holding that there was sufficient “evidence supporting defendants’ contention that OK legitimately terminated these plaintiffs because they had ceased to aggressively promote and sell the OK tire line of their own choosing.” A good summary is found in Boling, Franchise Terminations Under the Sherman Act: Populism and Relational Power, 53 Tex. L. Rev. 1180, 1206-07 (1975).

435. Copy-Data Sys., Inc. v. Toshiba Am., Inc., 755 F.2d 293, 300 (2d Cir. 1985); Trace X. Chem. v. Canadian Indus., Ltd., 738 F.2d 261, 267 (8th Cir. 1984) (upholding supplier’s refusal to deal except on a cash basis where dealer owed $160,000, cert. denied, 105 S. Ct. 911 (1985); Camfield Tires v. Michelin Tire Corp., 719 F.2d 1361, 1363, 1367 (8th Cir. 1983) (affirming summary judgment in favor of manufacturer in dealer’s suit alleging wrongful termination of dealership contract, where the dealer’s account was over 180 days past due); General United Co. v. American Honda Motor Co., 1985-2 Trade Cas. (CCH) ¶ 66,854 (W.D.N.C. 1985).


438. The courts have upheld termination decisions made after dealers refused to sign new forms of distribution agreements. Acme Refrigeration v. Whirlpool Corp., 747 F.2d 292, 293 (5th Cir. 1984); Corenswet, Inc. v. Amana Refrigeration, 594 F.2d 129, 131, 134 (5th Cir.) (upholding termination of distributor who alone among Amana distributors, refused to execute new standard form distributorship agreement which limited the term to one year; court recognized manufacturer’s interest in keeping all of its distributors under a single form of contract), cert. denied, 444 U.S. 938 (1979); Newport Tire & Rubber Co. v. Tire & Battery Corp., 504 F. Supp. 143, 147 (E.D.N.Y. 1980) (denying motion for preliminary injunction prohibiting defendant from termination of plaintiff’s distributorship; court found that defendant pressured the plaintiff to sign a “modified” distributorship agreement that included a provision permitting manufacturer to terminate the agreement if the distributor engaged in specified acts “detrimental to the interests” of the manufacturer); Zapatha v. Dairy Mart, 381 Mass. 287, 408 N.E.2d 1370, 1373 (1980) (two months after franchisor presented a new and more detailed form of “Independent Operator’s Agreement” to the franchisee for execution that contained some terms less favorable to the store operator than those of the existing agreement and franchisee refused to sign the new agreement, franchisor gave written notice to franchisee that the contract was being terminated effective in
these termination grounds: poor profitability, \textsuperscript{439} elimination of an ineffective dealer, \textsuperscript{440} and substitution of one dealer for another. \textsuperscript{441}

2. Material Breach

The dealer’s material breach of its agreement with the manufacturer is a sufficient reason to justify termination of the dealer agreement. \textsuperscript{442} Regardless of the particular terms of the dealer agreement, \textsuperscript{443} a manufacturer is almost always free to argue that the dealer’s poor performance constituted a material breach of the agreement, justifying the nonrenewal or termination decision. \textsuperscript{444} Although not grounds for termination, dealer’s breach that is not material may nevertheless support a defendant manufacturer’s claim for damages. The materiality of the dealer’s nonperformance raises questions of fact which may not be summarily determined. This section of the Article first defines material breach, then shows that the manufacturer can terminate the dealer agreement for material breach, and finally demonstrates the nature of the inquiry involved in such an argument.

A material breach, as defined in \textit{Lipsky v. Commonwealth United Corp.}, is a breach “which would justify the other party to suspend his own performance . . . , a breach which is so substantial as to defeat the purpose of the entire transaction.” \textsuperscript{445} More recently, holding that sufficient evidence existed to support jury verdict findings that alleged breaches of contract “were not material and did not justify termination of the franchise agreement,” the Seventh Circuit gave a shorter definition of material breach: a breach which defeats the object or underlying purpose of the contract. \textsuperscript{446}

Generally, a material breach excuses further performance by the non-breaching party. \textsuperscript{447} A number of recent federal circuit court cases have considered questions
regarding material breach as justification for the other party’s nonperformance. The
Seventh Circuit has stated the general rule “that only a ‘material’ breach of a contract
provision by one party will justify non-performance by the other party.” The
Eleventh Circuit recently recognized that a hamburger chain franchise could be
revoked for a material breach on the part of the franchisee. The court’s analysis
succinctly summarizes the rules of breach as they apply to dealer or distribution
agreements.

Whether a breach is material is a question of fact. In terminated dealer actions,
a manufacturer’s claim of material breach on the part of the plaintiff dealer will
necessarily raise issues requiring substantial discovery and a hearing.

The material breach cases involve two rules of law whose application require two
related inquiries: which party breached first and had the breaching party substantially
performed? “Clearly a breach can only occur when one is under an obligation to
perform in the first instance.” A number of states follow the rule that a party to an
agreement who first violates it cannot enforce it or recover on it. A manufacturer’s
decision to terminate a distributor will ordinarily be made as a result of poor
performance or failure of performance on the part of the dealer. Accordingly, those
states which have this “first breach rule” will permit the defendant manufacturer
to justify its decision to terminate (or not to renew) the dealership on the basis of the
prior breaches by the dealer. In other words, the act of termination cannot be a breach
of the agreement; the first material breach of the dealer excused the manufacturer’s
continued performance under the agreement.

Substantial performance and material breach are two sides of the same coin. “A
finding of substantial performance establishes that there was no material breach by”
the substantially performing party. The Fifth Circuit in Measday v. Kwik-Kopy
Corp. summarizes the relationship between substantial performance and material
breach; the court noted that “if a party has committed a material breach his
performance cannot be substantial.” Since the manufacturer’s acceptance of
performance alone does not constitute substantial performance, the manufacturer
should not be precluded from arguing that the plaintiff dealer had not substantially
performed its contract (or that the plaintiff dealer committed a material breach of the

450. Adams Apple Distrib. Co. v. Papalenas Reunidas, S.A., 773 F.2d 925, 929 (7th Cir. 1985); Canada Dry Corp.
v. Nehi Beverage Co., 723 F.2d 512, 517 (7th Cir. 1983) (“The materiality of a contractual breach is a question of fact
reserved for the jury.”); Sahadi v. Continental Ill. Nat’l Bank & Trust Co., 706 F.2d 193, 196 (7th Cir. 1983).
452. Apex Pool Equip. Corp. v. Lee, 419 F.2d 556, 562 (2d Cir. 1969); Abel of Ark., Inc. v. Richards, 236 Ark.
281, 289, 365 S.W.2d 705, 710 (1963) (party who first violates an agreement cannot recover in an action upon it); Hurley
453. The first material breach rule finds its rationale in the Restatement (Second) of Contracts § 237 (1981).
Comment B states in relevant part: “The central problem is in determining which party is chargeable with the first uncured
material failure of performance.”
454. Measday v. Kwik-Kopy Corp., 713 F.2d 118, 125 (5th Cir. 1983) (affirming judgment for damages against
a national franchisor of instant printing centers). Accord Casio, Inc. v. S.M. & R. Co., 755 F.2d 528, 531-32 (7th Cir.
1985).
456. Id. at 125.
contract) by the fact that the manufacturer accepted some benefits of the dealer's performance.

In sum, the proper analysis in a material breach case should be:

(1) Was there a breach by the distributor?
(2) Was the breach material?
(3) Was there substantial performance by the distributor?
(4) Was the breach by the distributor preceded by a breach on the part of the manufacturer?

3. Dishonest Practices by the Dealer

Aside from authorities regarding dishonesty and performance of contracts in general, the duty of good faith and fair dealing under the Uniform Commercial Code, and the law of fraud, a number of reported cases have denied injunctive relief or damages to dealers when the dealer has been found to have engaged in dishonest or unscrupulous practices. A review of the cases will indicate that in fact the conduct of these dealers can be broken down into two separate aspects. First, the dealer's conduct invariably violates the dealer agreement; second, following the unscrupulous practices, the dealer almost always falsely reports to the manufacturer about the dealer's conduct. Either or both of these grounds may constitute grounds for termination.

Courts have found a variety of dishonest practices to be violations of exclusive dealing arrangements or dealer agreements. The Tenth Circuit held that the distributors' action in analyzing a secret formula for the product, producing a similar product, and marketing it in small quantities violated an exclusive distributorship agreement. Those activities were not expressly prohibited by the agreement, but "amounted to bad faith which constituted a breach of the contract." In holding that the manufacturer was under no duty to continue to perform under the contract, the Tenth Circuit stated that the plaintiff's dishonest practices violated the relationship of mutual trust, confidence, and loyalty in an exclusive distributorship contract.

Other dealer cases have reached similar results. The Sixth Circuit held that an exclusive agreement for whiskey distribution was properly terminated after the

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457. 3 CORBIN ON CONTRACTS § 541, at 94–100 (1960).
458. Farnsworth, Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code, 30 U. Chi. L. Rev. 666, 672 (1963); Summers, "Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code, 54 Va. L. Rev. 195 (1968) (acting honestly is required by the duty of good faith; honesty is only the very beginning or essential element of good faith.).
459. Although attorneys usually think of fraud in the sense in which it is used in the expression "fraud in the inducement" of a contract, infrequently it has been loosely used to describe bad faith conduct in the nonperformance of a contract. W. KEHR, FRAUD & MISTAKE 42 (1872) ("All surprise, trick, cunning, dissembling, and other unfair way that is used to cheat anyone is considered as fraud."); Shonfeld v. Shonfeld, 260 N.Y. 477, 479, 184 N.E. 61 (1933) ("The Legislature perhaps adopted the traditional attitude of equity, which has ever refused to define, lest the craft of man evade the definition."); Brown v. Bonner, 35 Va. 1, 17 (1837) ("No principle is in equity better established than this, that though there may have been no fraud in the original transaction, yet the attempt to enforce it may become a fraud.") (emphasis in original); Rodman v. Thalheimer, 75 Pa. 232, 237–38 (1874) (holding that a purchaser's insolvency was not such fraud as to set aside the sale; to avoid the purchase there must be "artifice, trick or false pretence, as a means of obtaining possession, . . . . There must be bad faith, and intent at the time to defraud the seller.").
460. Cowley v. Anderson, 159 F.2d 1, 4 (10th Cir. 1947).
461. Id. at 5.
462. Id. at 3.
distributor padded its advertising expenses of which the distiller was required to pay half.\textsuperscript{463} A district court upheld a refusal to renew an automobile dealer's franchise when the franchisee dishonestly reported forty-four vehicle sales which were not in fact made and collected $5.85 for each of forty-four vehicle inspections which were not made.\textsuperscript{464} Similarly, a New York trial court dismissed an automobile dealer's petition for injunctive relief because the dealer had submitted claims for warranty repair work which had not in fact been performed.\textsuperscript{465} Moreover, in an action by a distributor seeking damages under the antitrust laws for wrongful termination, a district court granted summary judgment to a manufacturer who showed that the plaintiff had sent to defendant dishonored checks, deposited in its own account customer checks intended for the manufacturer, and kept erroneous records of machine rentals.\textsuperscript{466} Clearly, a dealer's dishonest practices may thwart its own claim for relief.

In a case that blurs the distinction between a violation of the dealer agreement and false reporting to the manufacturer, a trial court upheld the termination of an automobile dealership when the dealer had given false financial statements to the manufacturer, despite the lack of any demonstrated financial loss to the manufacturer.\textsuperscript{467} Similarly, \textit{Hornsby Oil Co. v. Champion Spark Plug Co.},\textsuperscript{468} an antitrust action, recognized that the distributor's falsification of monthly sales reports afforded a legitimate ground for termination of the distributorship.

\textit{Schwimmer v. Sony Corp. of America},\textsuperscript{469} held that the trial court should have granted a manufacturer's motion for judgment n.o.v. because the terminated dealer was involved in a scheme to submit false advertising claims, under a cooperative advertising program. An audit of all dealers in the region showed that "a number of Sony dealers had indeed submitted claims for advertising that had never been run." Nine dealers had submitted "false claims to Sonam totalling nearly $500,000 for commercials supposedly carried on two New York radio stations. The audit revealed that the commercials had never been aired and that the radio station invoices . . . had been forged."\textsuperscript{470}

Most dealer agreements have provisions which require the submission to the manufacturer or franchisor of financial statements and other reports. Submission of falsified reports should justify termination, because (a) the dealer is acting in violation of its duty of good faith to the manufacturer; and (b) falsified financial statements and reports are invariably submitted with the intention that the manufacturer will rely upon them to extend credit, to ship further products to the dealer, or to extend or renew the dealership. When a dealer submits false reports to the manufacturer for any of these
purposes, the specific transaction contemplated (e.g., the extension of credit, the shipment of inventory, or the extension of the dealer agreement) has been fraudulently induced; yet the manufacturer may find itself without recourse except as a secured creditor of the bankrupt dealer.

Analytically, dishonest conduct by a dealer can be considered a violation of the dealer’s duty to perform its contractual obligations in good faith. However, the cases have properly held that dishonest performance by the dealer goes to the root or essence of the agreement. Therefore, a dealer’s dishonest and unscrupulous practices should justify termination of the dealer agreement.\(^{471}\)

The manufacturer can strengthen its ability to take corrective action when confronted with dishonest practices, by including in the dealership agreement these specific grounds for termination: the dealer’s submission of materially inaccurate information, and the dealer’s failure to perform honestly any of its duties or obligations.

\section*{4. Termination for Reasons Unknown or Unstated at the Time of Termination}

Sometimes a manufacturer approaches counsel about terminating a dealer after the manufacturer has given notice of termination and specified the reasons for termination. Then counsel discovers and wishes to assert different or additional reasons for the termination. Sometimes after termination, or after the commencement of litigation, the manufacturer or its counsel discovers facts unknown to the manufacturer at the time of termination, which give rise to a justifiable termination. This section of the Article will examine the law concerning these later-found reasons for termination.

In general, a party to a contract is not constrained to assert only the reasons for termination given in the notice of termination.\(^{472}\) Similarly, the reasons given for the termination are not immutable; a manufacturer may change its stated reasons for termination.\(^{473}\) The leading case on this subject, \textit{College Point Boat Corp. v. United States},\(^ {474}\) held that a party to a contract may defend a suit for breach of contract on the ground that an excuse for nonperformance existed, even though at the time of nonperformance, the defending party was ignorant of that excuse.\(^ {475}\) This opinion, written by Justice Brandeis, has been widely quoted and applied.

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471. In an antitrust action (under both sections 1 and 2 of the Sherman Act) by a fruit and vegetable wholesaler against the lessor of a building used as a produce market, the First Circuit stated that a refusal to deal could be justified in circumstances involving “low business or ethical standards.” \textit{Gameco, Inc. v. Providence Fruit & Produce Bldg.}, 194 F.2d 484, 487 (1st Cir. 1952). \textit{Cf.} \textit{First Beverages, Inc. v. Royal Crown Cola Co.}, 612 F.2d 1164, 1173–75 (9th Cir. 1980) (defendant’s evidence regarding the illegality (under Interstate Commerce Commission rules) of the arrangement under which plaintiffs’ product was shipped to Los Angeles by truck, was properly admitted as relevant to damages issues), \textit{cert. denied}, 447 U.S. 924 (1980).


473. \textit{H.L. Moore Drug Exch. v. Eli Lilly & Co.}, 662 F.2d 935, 941 (2d Cir. 1981), \textit{cert. denied}, 459 U.S. 880 (1982); \textit{Gellhorn, supra} note 2, at 494–95. Without more, it is not a violation of the Sherman Act for a manufacturer to give to its terminated dealer “a false or inaccurate reason” for the termination.

474. 267 U.S. 12 (1925).

475. \textit{Id.} at 15–17.
For example, this principle has been applied in a contract action in which the defendant refused to accept anti-freeze under the contract, defending on the ground that the anti-freeze was not of sufficient quality. In another case, Frank Chevrolet Co. v. General Motors Corp., the dealer argued that failure to set forth a ground for nonrenewal of the dealership agreement constituted a waiver of that ground. The district court rejected the argument, holding that termination of the agreement could be justified by facts disclosed to the party during discovery procedures in the lawsuit. This holding has widespread application in terminated dealer litigation. Frequently the dealer's own records produced during discovery will reveal facts previously unknown that expose the dealer's actual performance (or lack of performance).

The College Point Boat principle has been applied to termination of agreements under contractual termination clauses. A party who has terminated a contract for a stated but unsupportable reason who later discovers a valid reason for cancellation, may rely upon the valid reason. Courts have also upheld contractual terminations even though the defendant specified the wrong reasons for termination. These cases demonstrate the need for broad discovery into the plaintiff dealer's performance. The courts have acknowledged this need. Not only are the standards for relevance in discovery quite liberal, but courts have upheld the right of a party to discover matters not alleged in the party's complaint.

D. The Bases for Counterclaims by a Defendant Manufacturer in a Terminated Dealer Action

This section discusses the grounds upon which a manufacturer sued by a terminated dealer may counterclaim for damages or injunctive relief. The starting point is the provisions of the distributor agreement, since many dealer agreements contain sections governing the rights of the parties upon termination or nonrenewal, including provisions regarding the manufacturer's obligation to repurchase certain unsold inventory, the obligation of the dealer to pay its outstanding amounts on account, and the dealer's obligation to cease use of the manufacturer's trademarks.

476. Western Auto Supply Co. v. Sullivan, 210 F.2d 36, 39-40 (8th Cir. 1954). RESTATEMENT (SECOND) OF CONTRACTS § 225 (1981) provides that the unexcused non-occurrence of a condition always prevents performance of the duty from becoming due and, if the condition does not occur within the time for its occurrence, has the additional effect of discharging the duty. The comment to that section provides the same rule concerning unknown events. Id. at comment e.


478. Id. at 319-20.


480. Broadstone Realty Corp. v. Evans, 251 F. Supp. 58, 64-66 (S.D. N.Y. 1966) (holding that a party to a contract can defend an action for breach even though "his grounds for being right included a large admixture of wrong reasons."), aff'd, 367 F.2d 397 (2d Cir. 1966); Newark Fireproofing Sash & Door Co. v. United States, 69 F. Supp. 121, 124 (Ct. Cl. 1947).

481. Fed. R. Civ. P. 26(b)(1) (one "may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter involved in the pending action.").

482. See, e.g., Rorer Int'l Cosmetics, Ltd. v. Halpem, 85 F.R.D. 43, 45 (E.D. Pa. 1979) (in a securities fraud action, the fact that plaintiffs had made no allegations concerning kickbacks in their complaint did not preclude them from discovery to determine if defendants had paid or received kickbacks; occurrence of kickbacks was relevant to the question of whether there had been fraud or misrepresentation in connection with the sale of stock).
The three principal types of counterclaims available to a defendant manufacturer in litigation with its terminated dealer are actions on an account unpaid by the distributor, actions for trademark infringement, and actions for defamation or trade libel if the dealer makes disparaging remarks about the manufacturer or its products to customers.

A manufacturer's action on an account is the most common counterclaim. Dealers will often run up a large balance owed on account during the period of time between receipt of notice of termination and the effective date of that termination. The dealer feels no obligation to pay that balance promptly since its relationship with the manufacturer has terminated. An action on an account, frequently a more simple piece of litigation than the claims raised by the plaintiff dealer, is often resolved by a motion for summary judgment while the plaintiff's claims remain pending. Although the distributor may be entitled to credit for goods that it returns to the manufacturer, the distributor may not attempt to disaffirm the distribution agreement as fraudulent; it has sued on that agreement for breach.

Most distribution arrangements include permission during the term of the dealer agreement for the dealer to use the manufacturer's trademarks triggering a second basis for a manufacturer's counterclaim, the Lanham Act. A terminated dealer's use of the manufacturer's trademarks after the effective date of termination gives rise to an action for damages and injunctive relief. The leading case, Burger King Corp. v. Mason, involved a restaurant franchisor who sued a franchisee for violations of the Lanham Act, alleging that the franchisee continued to use the franchisor's trademarks after termination. First, the court recognized that the "unauthorized use of a trademark which has the effect of misleading the public to believe that the user is sponsored or approved by the registrant can constitute infringement." Second, the court held that the franchisor had shown trademark infringement when it proved that the franchisee continued to use its trademarks after termination and that "a strong risk of consumer confusion arises when a terminated franchisee continues to use the former franchisor's trademarks." With respect to damages, the court noted that the Lanham Act permits the trial court considerable discretion, including permitting recovery of the defendant's profits, treble damages, and attorney's fees if the court believes that such an assessment would be just.

The third type of counterclaim that manufacturers sometimes assert is a claim for defamation or trade libel. Damages are difficult to prove on these claims, and the

483. Quality Performance Lines v. Yoho Automotive, 609 P.2d 1340, 1342-43 (Utah 1980) (in suit to recover on debt owed by distributor, court held that distributor was entitled, on termination of parties' relationship, to offset its indebtedness to the company by turning in certain components for credit against its account; that had been the parties' course of performance).
484. Crues v. KFC Corp., 729 F.2d 1145, 1153 (8th Cir. 1984) (plaintiff franchisee, having elected to affirm contract and sue for benefit-of-bargain damages, could not defend against counterclaim for unpaid royalties by disaffirming the contract as fraudulent or because the trademark for which royalties were to be paid, had no value).
487. Id. at 1492.
488. Id. at 1492-93.
489. Id. at 1495.
manufacturer will frequently fail to prove its claim.\textsuperscript{490} Unless the defendant manufacturer can prove more than isolated instances of such conduct, the defamation or trade libel claim is best avoided in a jury trial. A jury is likely to be put off by the manufacturer's thin claim regarding the terminated dealer's alleged misstatements.

IV. THE THIRD STEP: AVAILABLE REMEDIES IN DISTRIBUTORSHIP DISPUTES

This section discusses two types of remedies available in distributorship litigation: damages and injunctive relief. The injunction sought is usually a preliminary injunction. Other relief is meaningless because the terminated dealer will not find (following denial of its motion for preliminary injunction) any basis for the grant of permanent injunctive relief a year or two later when the harm caused by any unlawful conduct can be remedied in damages.

A. Damages

This section assumes that the distributorship agreement does not exclude particular types of damages,\textsuperscript{491} and explores the methodology of calculating damages, regardless of the particular theory of liability. A collection of significant cases has considered the issues concerning the types of damages recoverable by a terminated dealer and the proper methods by which they are calculated; some of these cases are antitrust cases, and some are state law cases. Together they establish the principle that although the plaintiff dealer has an obligation to mitigate damages by taking reasonable steps to market substitute lines of products,\textsuperscript{492} the plaintiff can recover damages for injury to its business, whether measured by its lost net\textsuperscript{493} profits, damage to the value of its business, or similar standards.

\textsuperscript{490} Charlottesville Music Center v. Magnepan, Inc., 655 F.2d 38, 40-41 (4th Cir. 1981) (in terminated dealer's antitrust suit against manufacturer in which manufacturer counterclaimed for product disparagement, manufacturer failed to establish a direct causal connection between its decrease in sales and the product disparagement). \textit{Cf.} First Flight Assoc. v. Professional Golf Co., 527 F.2d 931, 936 (6th Cir. 1975) (communication with sub-licensee of a trademark advising it of trademark ownership deficiencies and of a sales representative's lack of authority to bind the defendant contravalent, did not constitute trade libel or defamation).


\textsuperscript{492} Borger v. Yamaha Int'l Corp., 625 F.2d 390, 399 (2d Cir. 1980) ("Under Borger's duty to mitigate damages, it would have been remiss if it had not taken reasonable steps to merchandise substitute lines."); Golf City, Inc. v. Wilson Sporting Goods Co., 555 F.2d 426, 436 (5th Cir. 1977) ("An antitrust plaintiff has a duty to mitigate damages.").

\textsuperscript{493} The measure of lost profits is net profits. Bloomfield Fin. Corp. v. National Home Life Assurance Co., 734 F.2d 1408, 1411-12 (10th Cir. 1984); Graphic Prods. Distrib. v. Itek Corp., 717 F.2d 1560, 1580 (11th Cir. 1983) ("An antitrust plaintiff may recover only lost net profits."); Zell-Aire, Inc. v. Zell-Aire Corp., 684 F.2d 174, 176 (1st Cir. 1982) ("Finally, for damage purposes, one is interested in net profits, not gross profits.") (emphasis in original); Don Burton, Inc. v. Aetna Life & Casualty Co., 575 F.2d 702, 708 (9th Cir. 1978) (the rule applicable "in a tort case" as well as "in a contract situation" is: "Where, as here, a business is terminated, rather than simply interrupted, and operating expenses consequently cease, net, and not gross, anticipated profits state the correct measure of damages."); Fury Imports v. Shakespeare Co., 554 F.2d 1376, 1387 (5th Cir. 1977) (evidence insufficient because no evidence of net profits, but only of gross profits, \textit{cert. denied}, 450 U.S. 921 (1981); Desktor v. Fox Grocery Co., 1973-1 Trade Cas. (CCH) ¶ 74,427 (3d Cir. 1973) (upholding dismissal of grocery franchisee's antitrust claim on ground that there was insufficient proof of damages; plaintiff's failure to produce evidence of net profit as opposed to gross profit meant that jury would have had to speculate as to the amount of damages.); Rangen, Inc. v. Sterling Nelson & Sons, Inc., 351 F.2d 851, 855 (9th Cir. 1965), \textit{cert. denied}, 383 U.S. 936 (1966); Wolfe v. National Lead Co., 225 F.2d 427, 431 (9th Cir.) ("The only way of ascertaining whether the business was more profitable in one year than another is by comparing the net profits for one
In general, the two types of damages recoverable are lost net profits and injury to or destruction of the value of the business. The cases are split as to whether these two types of damages are duplicative, or distinct. Courts have identified three traditional measures of damages: (1) the before and after approach, which compares a plaintiff's profit or loss in two distinct time periods, using his own business and its performance to calculate damages; (2) the yardstick theory, which compares the plaintiff's profits during the period of the unlawful conduct to the profits of a similar company that was not adversely affected by the unlawful conduct; and (3) the market share theory, which calculates the market share lost by plaintiff in dollars, multiplying that dollar volume by plaintiff's profit margin.

A handful of United States Supreme Court opinions in the antitrust area establish the principle that damages need not be calculated with absolute exactness; an approximation based upon a reasonable basis of computation is adequate. A defendant whose wrongful conduct has rendered difficult the ascertainment of the plaintiff's precise damages is not entitled to complain that damages cannot be measured with the same precision as would otherwise be possible. Once the fact of damage has been shown, a lesser measure of proof is necessary to establish the amount of damages.

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494. Pierce v. Ramsey Winch Co., 753 F.2d 416, 429 n.15 (5th Cir. 1985); Farmington Dowl Prods. Co. v. Forster Mfg. Co., 421 F.2d 61, 81 (1st Cir. 1969); Graphic Prods. Distribs. v. Itek Corp., 717 F.2d 1560, 1579 (11th Cir. 1983);


497. See, e.g., Builders Windows v. Ceco Steel Prods. Corp., 209 F. Supp. 376, 379 (N.D. Ill. 1962) (“One recognized method of measuring prospective profits is the profit plaintiff made under the contract which was breached during a period prior to its breach.”).

498. See, e.g., Fargo Glass & Paint Co. v. Globe Am. Corp., 201 F.2d 534, 540-41 (7th Cir.), cert. denied, 345 U.S. 942 (1953), in which the plaintiff said that the defendant Globe American Corp. cancelled plaintiff's distributorship contract and arranged to sell its (Globe's) entire output of gas ranges to the Maytag Co. for resale by the Maytag Co. The district court had found that Maytag made a net profit from resale of Globe's ovens, and entered judgment for treble that amount. The court of appeals held that the damages awarded to the plaintiff were “improperly measured”:

The profits made by Maytag are not the proper measure of plaintiff's damages. There is no evidence to justify the assumption that plaintiff would have sold the same number of Globe ranges that Maytag sold, or that it would have realized the same profit on sales it made. The record is silent as to the comparative cost of doing business by Maytag and plaintiff. Damages to be recoverable must be actual not speculative, remote or uncertain.

Id. This quotation emphasizes the key requirement of the yardstick theory: the yardstick must be comparable to the plaintiff's business.

Flinkote Co. v. Lysfiord,\textsuperscript{500} summarized the three common types of evidence used to prove damages:

There are three chief types of evidence which the decisions have approved as the basis for the award of damages. (1) Business records of the plaintiff or his predecessor before the conspiracy arose. (2) Business records of comparative but unrestrained enterprises during the particular period in question. (3) Expert opinion based on items (1) or (2).\textsuperscript{501}

These principles have been applied in terminated dealer litigation. In \textit{Joseph E. Seagram & Sons, Inc. v. Hawaiian Oke & Liquors, Ltd.},\textsuperscript{502} the Ninth Circuit examined a terminated distributor's proof of damages, finding it insufficient and speculative because based upon unwarranted assumptions.\textsuperscript{503} The Court noted: "Plaintiff's charts are 'an array of figures conveying a delusive impression of exactness in an area where a jury's common sense is less available than usual to protect it' . . . They should not have been admitted."\textsuperscript{504} The rule that the plaintiff is not required to prove the amount of damages with mathematical certainty "does not mean that the door is open to present to a jury the kind of rampant speculation that went to the jury in this case."\textsuperscript{505} Although the above cases are antitrust actions, the same general damages principles have been applied in breach of contract actions.\textsuperscript{506}

Damages for breach of contract begin with the familiar rule that the nonbreaching party is entitled to be placed in as good a position as it would have been in the absence of the breach. This principle applies in termination of distributorship agreements.\textsuperscript{507} The leading case on the calculation of damages in a terminated dealer action is the opinion of the Fifth Circuit in \textit{C.A. May Marine Supply Co. v. Brunswick Corp.}.\textsuperscript{508} In this action under the Wisconsin dealer protection statute, the court set forth the applicable principles of damage calculation, distinguishing between the lost profits (and the "yardstick" and "before and after" theories to calculate them) and the loss of going concern value as measures of recovery.\textsuperscript{509} Interestingly, the court used the
concept of foreseeability to limit the recovery of damages for destruction of the business; the court stated that the manufacturer "could not have foreseen that collapse of the entire business would result from nonrenewal of one product line."\(^{510}\) It also expressed a preference for calculation of the lost future profits by the before and after approach, rather than the yardstick approach, since the plaintiff dealer "was an ongoing business with a profit record."\(^{511}\) However, even a money-losing business can recover an award of lost profits; a plaintiff could have either suffered a loss or made a profit and still have been injured by unlawful conduct.\(^{512}\)

The cases reach various results concerning the length of time for which damages may be awarded.\(^{513}\) In cases in which the required notice of termination was not given, some decisions have held that damages are recoverable only for the period of notice.\(^{514}\)

In conclusion, the recovery of damages in a terminated dealer action is governed by the same general rules that apply to the recovery of damages in other types of cases. Damages must be proved with reasonable certainty; neither their existence nor their amount may be speculative.

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\(^{510}\) Id.

\(^{511}\) Id.

\(^{512}\) Jay Edwards, Inc. v. New Eng. Toyota Distrib., 708 F.2d 814, 819–20 (1st Cir.) (in action by auto dealership against regional distributor of automobiles for violation of New Hampshire statutory equivalent of federal Dealers' Day in Court Act, jury verdict of over $1.4 million plus prejudgment interest was reduced by $950,000 and remanded for recalculation of prejudgment interest; although the damage award for period of distributorship reflected annual profits proportionately far greater than dealership ever made or its competitors achieved, amount of award did not exceed any rational estimate that could be based upon evidence in the record), cert. denied, 464 U.S. 894 (1983); Graphic Prods. Distribrs. v. Itek Corp., 717 F.2d 1560, 1582 (11th Cir. 1983) ("A business need not have been operating at a profit in order to recover lost future profits."); Allegheny Pepsi-Cola Bottling Co. v. Mid Atl. Coca-Cola Bottling Co., 690 F.2d 411, 415 n.4 (4th Cir. 1982); Bueno Sales v. Chrysler Motors Corp., 449 F.2d 715, 720 (3d Cir. 1971) ("Even a business which has suffered a net loss before the breach is entitled to damages if the breach deprives it of additional revenue which it could have used to help defray its overhead expenses."). Compare Universal Lite Distribrs. v. Northwest Indus., 602 F.2d 1173, 1175–76 (4th Cir. 1979) (reversing award of lost profits from termination of distributorship because of insufficiency of evidence of lost profits) with Spray-Rite Serv. Corp. v. Monsanto Co., 684 F.2d 1226, 1240–44 (7th Cir. 1982) (affirming judgment entered on jury verdict of $3.5 million in distributorship action, and reviewing admissibility of expert damage testimony and method of calculation of damages), aff'd on other grounds, 465 U.S. 752 (1984). The court also held that "disaggregation" of damages according to each illegal practice was not required. Id. at 1243. Cf. Litton Sys. v. American Tel. & Tel. Co., 700 F.2d 785, 825 (2d Cir. 1983) ("AT&T correctly points out that courts have held that damage studies are inadequate when only some of the conduct complained of is found to be wrongful and the damage study cannot be disaggregated.")., cert. denied, 464 U.S. 1073 (1984).

\(^{513}\) Compare Jay Edwards, Inc. v. New Eng. Toyota Distrib., 708 F.2d 814, 822–23 (1st Cir.) (damages for lost profits could not be awarded for period after plaintiff's supplier had ceased to be automobile distributor), cert. denied, 464 U.S. 894 (1983), with Borgcr v. Yamaha Int'l Corp., 625 F.2d 390, 398 (2d Cir. 1980) ("Accordingly, recovery is generally limited to damages suffered to the date of filing the complaint, although in an appropriate case, the trial court may permit supplementation of the complaint to allow for recovery of damages up to the time of trial." (citations omitted)) and Westman Comm'n Co. v. Hobart Corp., 541 F. Supp. 307 (D. Colo. 1982) (permitting recovery of lost "follow-on sales" up to the last day of trial).

\(^{514}\) Sierra Wine & Liquor Co. v. Heublein, Inc., 626 F.2d 129, 131–32 (9th Cir. 1980) (where reasonable notice of termination was required but not given, six months' lost profits awarded); JBL Enters. v. Hirnack Enters., 519 F. Supp. 1084 (N.D. Cal. 1981) (agreement said either party could terminate on thirty days written notice; plaintiff's damages limited to lost profits during period from date of alleged breach (October 1979) to effective date of termination (January 1980), aff'd, 698 F.2d 1011 (9th Cir.), cert. denied, 464 U.S. 829 (1983); Des Moines Blue Ribbon Distribrs. v. Drewrys Ltd., 256 Iowa 899, 129 N.W.2d 731 (1964) (damages based on profit on sales plaintiff would have made during period of time after receipt of notice of termination).
B. Injunctive Relief

When a distributor decides to seek injunctive relief against termination, the preliminary injunction is all important. If the dealer loses that motion (and usually he will, if only because damages are an adequate remedy at law), the status quo prior to litigation will not be preserved and a future permanent injunction is meaningless and inappropriate. Therefore this section explores the law of injunctive relief, focusing upon the motion for preliminary injunction,\(^{515}\) which in a terminated dealer action is very much like specific performance.\(^{516}\) In essence the dealer plaintiff wants specific performance of certain provisions of the distributor agreement. In an injunction action the plaintiff dealer usually argues that it is an innocent party threatened with destruction, relying upon cases which hold that the necessary requirement of irreparable harm is shown if the defendant's actions threaten the loss or destruction of the plaintiff's business.\(^{517}\)

Nevertheless, "a moving party possesses an adequate remedy at law if the act at issue threatens only a disruption in an ongoing business, and not its destruction."\(^{518}\) The plaintiff distributor usually argues that its survival is at stake and that a permanent injunction alone would be too late to save it. Yet the Seventh and Eighth Circuits have dealt with such a "now or never" argument, rejecting the proposition that the plaintiff has no realistic hope of relief in damages if a preliminary injunction is wrongfully denied, reasoning that one who cuts off a dealer during litigation does so "at its own risk."\(^{519}\) Further, the cases holding that the threatened loss or destruction of a distributor's business constitutes irreparable injury are predicated upon the idea that the lost goodwill and business are difficult to prove and to quantify

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\(^{516}\) The leading case considering specific performance in the context of a distributor termination is Guinness-Harp Corp. v. Jos. Schlitz Brewing Co., 613 F.2d 468, 470-73 (2d Cir. 1980), which affirmed the grant of a preliminary mandatory injunction against termination of a beer distributorship, pending arbitration between the parties under a distributorship agreement. The court recognized that "an injunction against termination of the distributorship prior to arbitration" and "specific performance of the arbitration agreement prior to termination" were "merely different legal theories for the same relief." Id. at 472 n.5. The court held that specific performance was appropriate in that situation. Id. at 473. In contrast, Copylease Corp. of Am. v. Memorex Corp., 408 F. Supp. 758 (S.D.N.Y. 1976) held that under California law the provision in a contract granting an exclusive territory "is not in itself an adequate basis" for the award of specific performance of the contract, and that both the availability of damages, and the difficulties of enforcing a contract that requires cooperation between the parties could be sufficient to bar the award of specific performance. Id. at 759-60.


Although damages for lost goodwill are difficult to quantify, damages suffered by a distributor that was unlawfully terminated are not impossible to quantify.

A subtle and usually overlooked point is whether an adequate remedy at law means simply an available remedy in damages. Put another way, are "adequacy" and "availability" of a remedy in damages equivalent concepts? The better authorities have held that since damages are calculable for lost profits or injury to the value of a business, an adequate remedy at law in damages precludes the grant of injunctive relief. The only exception to this rule should be instances in which the agreement between the parties itself contains provisions for termination and an injunction is issued restraining termination until those procedures are followed.

In addition to these problems with the fundamental requirement of irreparable harm, problems with respect to enforceability of preliminary injunctions exist. The courts are reluctant to issue preliminary injunctions which in effect give to either party any distributorship rights for a long period of time because a distributorship, akin to a personal services contract, requires the cooperation of the parties and the personal efforts of the dealer. For example, one court denied a mandatory preliminary injunction to compel a bedding trademark licensor to allow a licensee to manufacture bedding, reasoning that rather than seeking to freeze the status quo, the licensee was seeking a permanent position through litigation. In strong terms, the Second Circuit has expressed concern about the use of preliminary mandatory injunctions to enjoin the termination of dealerships on antitrust grounds. The court stated that "the granting of such a preliminary mandatory injunction amounts as a practical matter, as here, to freezing plaintiff's revocable and hence temporary dealership into a dealership non-revocable for a substantial period." The court recognized the undesirability of the situation in which the manufacturer "will be frozen into an intimate and

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521. Agricultural Servs. Ass'n v. Ferry-Morse Seed Co., 551 F.2d 1057, 1070-72 (6th Cir. 1977) (in breach of warranty action, reversing as clearly erroneous a magistrate's findings with respect to damages for loss of goodwill). See also the authorities collected in Schwartz v. NMS Indus., 575 F.2d 553, 554 n.1 (5th Cir. 1978).
522. See, e.g., Luis Rosario, Inc. v. Amana Refrigeration, 733 F.2d 172, 174 (1st Cir. 1984) (in a suit under Puerto Rico Dealer's Act, court affirmed denial of preliminary injunction; dealer could be compensated by damages); American Can Co. v. A.B. Dick Co., 1983-2 Trade Cas. (CCH) ¶ 65,751 (S.D.N.Y. 1983) at p. 69,830 (plaintiff "has not shown that the effects of the claimed breach on its business are of sufficient magnitude to remove it from the rule that irreparable injury means injury for which monetary damages cannot adequately compensate a plaintiff, entitling it to preliminary relief.").
524. Rittmiller v. Blex Oil, Inc., 624 F.2d 857, 861 n.4 (8th Cir. 1980) ("The availability of treble damage relief is an important consideration, however, weighing against granting an interlocutory injunction."); Ohio-Scaly Mattress Mfg. Co. v. Duncan, 548 F. Supp. 75 (N.D. Ill. 1982) (also stating that the availability of treble damages under the antitrust laws was an important factor weighing against a finding of irreparable harm and inadequacy of legal remedies), appeal dismissed, 714 F.2d 740 (7th Cir. 1983), cert. denied, 464 U.S. 1044 (1984).
525. Jack Kahn Music Co. v. Baldwin Piano & Organ Co., 604 F.2d 725, 757 (2d Cir. 1979) (emphasis added). See also two recent opinions by Circuit Judge Posner, in which the Seventh Circuit has reviewed extensively the law of preliminary injunctions in antitrust and distributorship cases. Roland Mach. Co. v. Dresser Indus., 749 F.2d 380 (7th Cir. 1984); General Leaseways v. National Truck Leasing Ass'n., 744 F.2d 588 (7th Cir. 1984). These cases were further explained by Judge Posner in his opinion articulating the tests for a preliminary injunction as an arithmetic formula. American Hosp. Supply v. Hospital Prods. Ltd., 780 F.2d 589 (7th Cir. 1985).
continuous relationship with a dealer it no longer wishes to be associated with." 526 Similarly, the Fifth Circuit has recognized that "the injunction has the effect of forcing these antagonistic parties to maintain their relationship indefinitely and requiring the continuous supervision of the district court." 527 In addition, the courts are very reluctant to use the tool of a preliminary injunction to make orders with respect to monetary payments between parties. 528

The best exposition of the problems of the use of injunctions to prevent termination of distributorships, contained in Autowest, Inc. v. Peugeot, Inc., recognized that the "galling harness of an injunction cannot create teamwork." 529 The Second Circuit has had the most occasions to consider the propriety of the issuance of a preliminary injunction in a terminated distributorship context. Jackson Dairy v. H.P. Hood & Sons, Inc. 530 reversed the grant of a preliminary injunction in an action by a distributor against a manufacturer alleging breach of an exclusive distributorship agreement. 531 The Second Circuit held that the plaintiff distributor failed to demonstrate that money damages would not be adequate compensation for the claimed breach of the agreement, reaffirming the principle that "where money damages is adequate compensation a preliminary injunction will not issue." 532 "Clearly, money would be adequate compensation for the loss of [certain customers], or other business if Jackson demonstrates that Hood breached its contract with Jackson." 533 Finally, the court also held that the alleged harm concerning disruption of the plaintiff's sales and delivery relations with its customers and suppliers would "be rather readily compensable in monetary damages." 534

A few months after Jackson Dairy, the Second Circuit in Jack Kahn Music Co. v. Baldwin Piano & Organ Co., 535 reversed the grant of a mandatory preliminary


527. Corenswet, Inc. v. Amana Refrigeration, 594 F.2d 129, 134 (5th Cir.) (quoting Refrigeration Eng'g Corp. v. Frick Co., 370 F. Supp. 702, 715 (W.D. Tex. 1974)), cert. denied, 444 U.S. 938 (1979): [D]ifficulty of enforcement is, in itself, often a sufficient reason for denying injunctive relief. The Court should not be called upon to weld together two business entities which have shown a propensity for disagreement, friction, and even adverse litigation. (citations omitted).


529. Id.

530. 596 F.2d 70 (2d Cir. 1979).

531. The 1967 distributorship agreement in that case gave the distributor an exclusive territory of Vermont and New Hampshire. Id. at 71.

532. Id. at 72.

533. Id. (footnote omitted).

534. Id. at 73.

injunction in an antitrust action seeking to enjoin a manufacturer from cancelling a retail dealership in pianos, organs, and other musical instruments. The Second Circuit held (1) that the requirement of irreparable harm was not satisfied on the theory of an incalculable effect of the termination on the public and on the dealer’s goodwill; (2) that the injuries alleged were compensable in damages; (3) that despite the language in earlier cases appearing to support the issuance of injunctions in dealership cases, there is still a "basis requirement in all cases in equity that there must be proof that there is no adequate remedy at law." 

Although in one subsequent opinion the Second Circuit distinguished Jack Kahn Music on the ground that the distributorship in Jack Kahn Music was not the foundation of the plaintiff's business, both Jack Kahn Music and Jackson Dairy continue to be the leading cases concerning the availability of injunctive relief in terminated distributorship situations in the federal courts. Although there are certainly cases upholding the issuance of injunctions in distributorship situations, the lower court cases have usually denied preliminary injunctions to terminated distributors. While the cases present a variety of fact situations, these courts usually express concern about forcing reluctant parties to deal with one another, and about the necessity for and the inability of the courts to provide supervision. For example, one court held that a preliminary injunction seeking to prevent the manufacturer from terminating a franchise would be denied, even though the plaintiff had been a distributor of the corporate defendant's products for approximately thirty years, because "it will be apparent that the plaintiff seeks to induce the court to direct pro tanto, the operations of the defendants' business, which is a large undertaking and

536. In its letter of termination, the manufacturer assured the plaintiff dealer that the manufacturer would continue to supply instruments necessary to meet sales commitments which the plaintiff obtained on bids submitted before the date of termination. 604 F.2d 755, 761. Such a move is both fair dealing and wise precaution.

537. Id. at 761–63. Accord Buckingham Corp. v. Karp, 762 F.2d 257, 261–63 (2d Cir. 1985).


539. Id. at 762.


541. Although there are few reported cases, the state cases are in agreement with these principles. One of the leading cases is Thayer Plymouth Center v. Chrysler Motors Corp., 255 Cal. App. 2d 300, 63 Cal. Rptr. 148 (1967), which reversed the grant of a preliminary injunction enjoining an automobile manufacturer from terminating a dealership agreement. The Thayer opinion contains one of the best discussions of the law of preliminary injunctions and specific performance as it applies to termination of dealership agreements. Among other points, the court held that an agreement "which requires a continuing series of acts and demands cooperation between the parties for the successful performance of those acts is not subject to specific performance." Id. at 303, 63 Cal. Rptr. 148, 150. Neither preliminary nor permanent injunctive relief preventing termination of an exclusive distributorship contract will be granted where such an injunction would in effect specifically enforce the dealership agreement, and "would require a manufacturer to entrust the marketing of its products in a wide area to a distributor with whom a relationship of confidence and cooperation has been rendered impossible by reason of the pendency of the lawsuit." Id. at 304, 63 Cal. Rptr. 148, 151. An adequate remedy at law in damages existed; the dealer could recover damages for breach of the agreement. Id. at 305–06, 63 Cal. Rptr. 148, 151–52.

542. See, e.g., Gerard v. Almouli, 746 F.2d 936 (2d Cir. 1984) (affirming preliminary injunction requiring defendant to comply with terms of exclusive dealer agreement despite the Jackson Dairy opinion of that circuit); Trabert & Hoefer, Inc. v. Piaget Watch Corp., 633 F.2d 477, 483 (7th Cir. 1980) (a powerful name brand trademark which supported finding of harm from loss of the line and the value of a nationally advertised franchise was a matter of general recognition); R&Q Affiliates v. Knoll Int'l, 587 F. Supp. 1395 (S.D.N.Y. 1984) (in almost all of the decisions enjoining a threatened dealership termination, the distributorship represented a substantial portion of the plaintiff's business).
would be justified only under the most exigent of circumstances." 543 "The court should hesitate before granting a preliminary injunction which would require ‘defendants to indefinitely entrust the marketing of their product in a wide area to a distributor with whom a relationship of confidence and cooperation has become impossible.’" 544 The trial courts have also repeatedly held that there was an adequate remedy at law in damages, and that irreparable harm was not shown because the injury was compensable in money damages. 545 Yet these principles are difficult to apply. 546

V. Conclusion

The purpose of this Article is to review the factors underlying the strategic decisions in terminated distributorship litigation. Analysis of these issues will help to avoid mistakes frequently made by terminated distributors such as (1) failures to write to the manufacturer about problems experienced by the dealer (too often the distributor relies upon oral communications with the manufacturer and its representatives); (2) overreliance in the dealer’s business on one line of product, rather than reduction of the distributor’s need for one manufacturer by handling alternative lines; (3) futile attempts to avoid an arbitration agreement which result in the distributor’s loss of time and money in litigating whether its claims must be arbitrated; and (4) the distributor’s greed in pursuit of both injunctive relief and damages, when usually only one type of relief is appropriate.

Manufacturers make mistakes such as failing to have a written distributor agreement, or to have one that addresses all of the issues necessary to the proper structure of a distribution system; and ignorance of the provisions of their own dealer agreements when they do have such agreements.


A Practitioner's Checklist of Facts and Questions to be Reviewed with Client

It is useful to set forth the list of points that the author uses to review with a client contemplating a prospective dealership termination or nonrenewal:

1. Location and territory of dealership;
2. Date of dealer agreement and modifications;
3. Applicable state statutes;
4. Reasons for the proposed termination:
   (a) Why is the dealer a problem?
   (b) For how long has it been?
   (c) Violations of dealer agreement?
   (d) Sales performance?
      (i) Is it declining?
      (ii) How does client measure poor performance?
   (e) Financial condition and credit problems;
   (f) Dealer personnel problems/turnover;
5. What does client wish to do?
   (a) Termination/nonrenewal;
   (b) Credit restrictions;
   (c) Reduction of territory;
   (d) National accounts;
   (e) Replacement with another dealer;
6. Litigation evaluation:
   (a) Likelihood of litigation;
   (b) Will termination force dealer out of business?
      (i) Other competing lines;
      (ii) Percent of volume/profit of the dealer composed of this product line or brand;
      (iii) Dealer's financial condition;
   (c) Recent meetings/conversations with dealer;
      (i) Discussion of litigation;
      (ii) What has dealer been told concerning performance or termination;
      (iii) Analysis of dealer's explanations or excuses;
      (iv) Documentation of meetings/conversations by letters to the dealer or memoranda to the file;
   (d) Complaints about dealer from customers or other dealers;
   (e) Has the client engaged in the following practices:
      (i) Disparagement of dealer's operations to potential customers;
      (ii) Threatened litigation with dealer;
      (iii) Taking customers or sales away from dealer;
      (iv) Withholding commissions claimed by dealer;
      (v) Hiring away dealer's personnel or encouraging them to set up another dealership;
      (vi) Talking to other dealers about potential termination of this dealer;
      (vii) Any conduct which would reduce dealer profits.
7. Discussion of the following steps to be taken:
   (a) Review of dealer agreement and modifications to it;
   (b) Review of manufacturer's files regarding this dealer;
   (c) Examination of the termination as justified for the following reasons:
      (i) Increase in sales and market penetration;
      (ii) Relief of manufacturer from ineffective distributor;
      (iii) Provision of better service to customers;
      (iv) Reduction of credit risk by ridding manufacturer of undercapitalized or financially weak or unsound distributor;
   (d) Meeting with dealer to describe to it the problems of the dealership, followed up with a letter to the dealer documenting those points;
   (e) If a decision is made in favor of nonrenewal or termination, then give maximum notice required by dealer agreement or by applicable statute, whichever is longer.