CORPORATE

UNITED STATES: THE "TOP TEN" THINGS FOR A SUPPLIER TO CONSIDER IN TERMINATING A DISTRIBUTOR

by Ken McIntyre

Regardless of labels like "dealer," "distributor" or "reseller," there are some fundamental issues that demand attention whenever a supply relationship is involuntarily terminated. We work with suppliers in planning and implementing decisions to terminate. We also successfully defend these decisions through negotiation, litigation or alternative dispute resolution. We have litigated termination disputes under various state and federal laws and have appeared in state and federal courts and before arbitration panels throughout the country to successfully defend termination decisions.

Based on our extensive, actual "battle experience," we offer the following ten areas of concern to bear in mind when contemplating an involuntary termination:

1. **Keep termination planning communications confidential.** Generally, all documents and communications, including e-mails, within a company regarding the performance of a distributor and the decision and plan to end the relationship are subject to discovery. The only effective way to maintain confidentiality is to work with attorneys who can give advice within the protective shield of the attorney-client privilege.

2. **Drill down to determine the actual reason for the termination.** Even if written agreements provide for termination "without cause," understanding the motivation and rationale for the decision to terminate is critical. Nothing can undermine your prospects in litigation more than a revelation during the course of a lawsuit that the "real reason" for the termination is other than the stated one. Evaluate whether the termination decision is made pursuant to objective, non-discriminatory criteria. Examine the adequacy of the "paper trail" that confirms the termination decision. Senior management personnel making the ultimate decision should be interviewed, but perhaps more important are interviews of mid-management and "area reps" who are the primary contacts. Not only should corporate finance and contract distributor relationship files be reviewed, but so should the files and records of all relevant field personnel.

3. **Carefully review the contract documents and agreement.** Do you have the actual signed current agreement? Are there any "updates" or letter amendments and have they been signed or acknowledged? What's the standard for termination? Is "good cause" required? Is notice required and how much time? Is there a cure requirement? If the contract is "at will," are there state law obligations of "good faith and fair dealing" that apply? If the distributor breached the agreement, what evidence exists to prove the breach? Does the agreement contain provisions for choice of law or place of litigation or arbitration and are they enforceable?

4. **If there is no integrated express written contract, what defines the relationship?** Is there a contract by virtue of express oral agreement or communications showing a course of performance? Is there a basis for implying contractual commitments arising out of company policies, manuals or statements of procedure? Is it a purchase order by purchase order relationship? If so, what terms and conditions will determine the "battle of the forms"?

5. **Despite the contract, what other laws may apply to the termination?** Even express written contract provisions may be overridden by other laws. Many states have "fair dealership laws" which apply if there is a "community of interest" which would invoke the policy of a state statute for the protection of a dealer who resides in the state. Such statutes frequently require and delineate what constitutes "good cause" for termination and prescribe notice and a right to cure. These statutes may also provide for easier injunctive relief standards and the shifting of the burden of proof.

   Some state statutes govern specific supply relationships, like motor vehicle, petroleum, farm implements, beer, wine, light industrial equipment, independent sales representatives, liquor, marine boats and motors, motorcycles, RVs, soft drinks, and swine and poultry marketing.

   Some states have "inventory buy back" laws requiring purchase of inventory. Others have case law which follows the so-called "Missouri Rule" that, as a matter of equity and restitution, the terminated distributor must be given a fair opportunity to recoup its development investment.

   Lastly, check for applicable federal statutes, including the Petroleum Marketing Practices Act, 15 USC §2801, the Federal Automobile Dealer Day in Court Act, 15 USC §1221, the Sherman Antitrust Act, 15 USC §1, and FTC Franchise Rules 16, CFR §4-36 (1997).

6. **What counterclaims or defenses may the distributor assert?** Determine whether the distributor may respond with some allegation of wrong doing or retaliation by the supplier. Ask about complaints from other distributors or other channels of distribution. For example, have there been complaints about the distributor's violation of a minimum advertised price policy or suggested retail price policy? Have there been complaints against the distributor for selling outside its assigned area of primary responsibility or unauthorized product or "grey goods" sales overseas? Has the distributor made prior complaints, including those about alleged lack of support, discrimination, unfair discounts and pricing policies or billing mistakes? Was the decision to terminate made in response to concerns of a "dealer counsel" or another group of dealers which could open the company to allegations of conspiratorial boycott? Also, investigate the possible assertion of oral or partially integrated promises or agreements and whether the distributor may claim a right to cure or for a lesser sanction in lieu of termination.

7. **Consider whether there will be any post-termination issues that need to be addressed.** Does the dealer exhibit trade or service marks of the supplier? Are there license agreements as to the limited authority to do so and the requirement of cessation of activity and the return of signage? Are there issues pertaining to the return of proprietary information and trade secrets? Does the written agreement provide for injunctive relief in the event of a refusal to comply with post-termination obligations?

8. **Will there be allegations of an "implied franchise"?** Generally speaking, a franchise may be express or implied in writing or orally. The elements usually include the right to sell goods or services under a "marketing plan," that the goods or services are "substantially associated" with a trademark and the payment of a direct or indirect franchise fee. Consequently, you should examine the facts to see if these elements are arguably present under the elements of the specific state Franchise Investment Act. Pay special attention to any fees paid by the distributor for services or equipment and if such fees were inflated.

9. **Avoid the temptation to have a meeting with the terminated distributor to explain where it went wrong.** Once the decision to terminate is made, there should be nothing to talk about. "Heart to heart" discussions frequently end up being the source of debate in litigation as to whether or not they were educational attempts to "dissuade" the terminated distributor from its inappropriate activity or whether they were illegal threats and coercion. Usually such discussions should be avoided. Further, any potential discussion should be carefully contemplated with knowledge that everything stated may be the subject of post-termination repetition and embellishment.

10. **Formulate a post-termination notice strategy.** Once the terminated distributor receives notice, it will likely contact representatives of the company to determine what's "really" going on. It may also use such inquiries as an opportunity to engage in a "set up" strategy of its own. It is not unheard of that recording devices are employed in such communications. The client needs to have a set procedure for handling any inquiries after the termination notice. The notice should state exactly to whom any inquiries should be directed. The company representative fielding these inquiries should be well educated on what to expect and, like the author of the termination letter, should be someone who can do a good job in explaining the company's position if testimony becomes necessary. Other persons who may receive contact from the terminated distributor should be instructed that they should engage in no substantive dialogue and that they should refer any inquiries to the designated company representative. Usually, the best advice is to respond that there is nothing to discuss beyond that which is contained in the letter.

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