



2022

CLE Weeks

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Ten Distribution Law Questions for In-house (and Outside) Counsel

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Introductions, Thank Yous and Promises

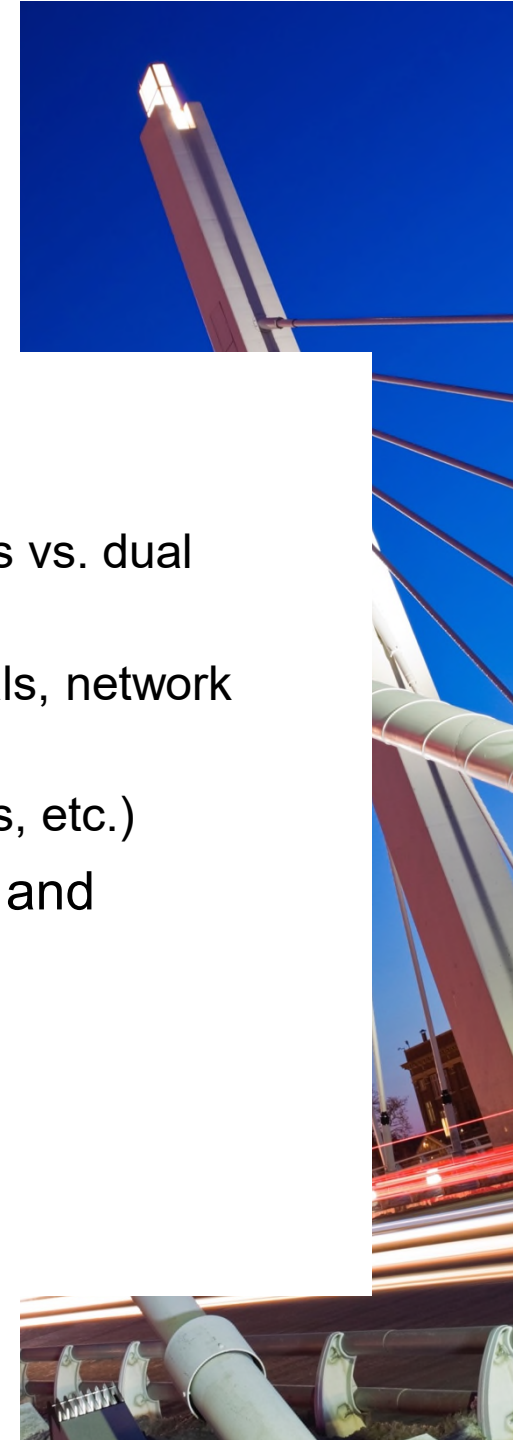


“What is distribution law?”



“What is distribution law?”

- The “downstream” portion of the product lifecycle
 - How you market and get your products to end users (direct sales vs. channel partners vs. dual distribution)
 - How your relationships with channel partners are regulated (terminations/non-renewals, network restructures, contract modifications, etc.)
 - How you support your products throughout their useful life (warranties, repair services, etc.)
- Intersection of (i) commercial contracts, (ii) state-specific laws and regulations, and (iii) federal laws and regulations
 - Each impacts how you “distribute” your products to the market



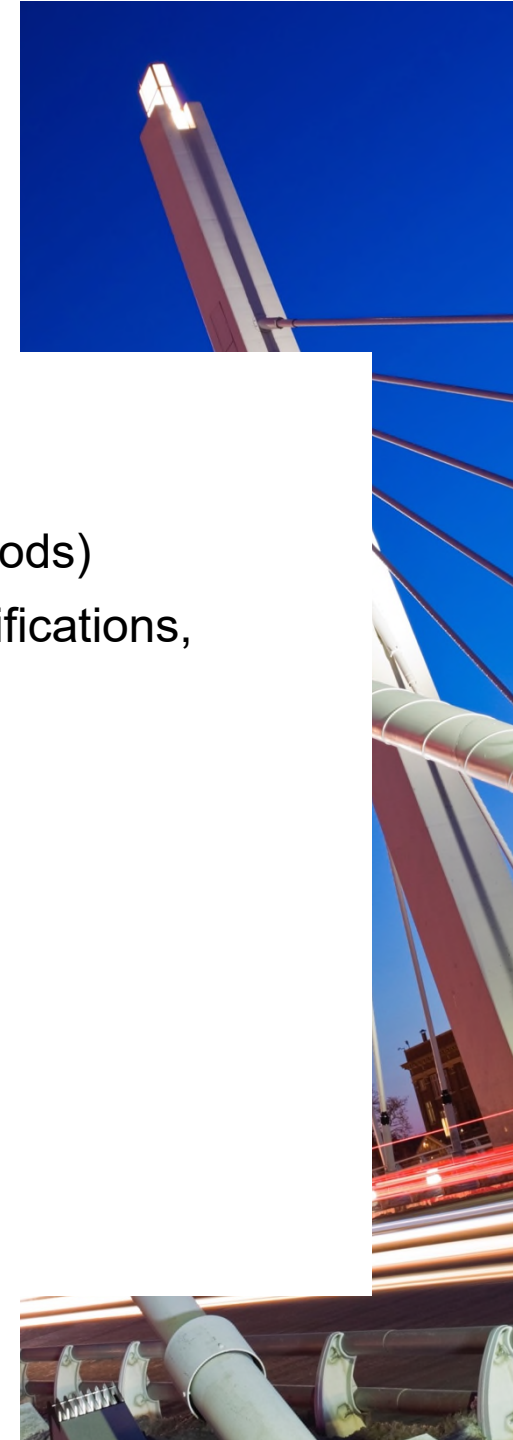
Distribution Law

- Don't singularly focus on terms of channel-partner contract
 - Important, but not exclusive source of obligations
 - Losing sight of extra-contractual obligations can be costly
- State distribution (and franchise) laws
 - Range of impacts on your business
 - Generally applicable vs. industry-specific vs. franchise
 - Pre- and post-contracting obligations
- Federal laws
 - Magnuson-Moss Warranty Act
 - FTC regulations



Distribution Law (cont.)

- How do these extra-contractual obligations impact your business?
 - Restrict (or enjoin) channel terminations/non-renewals (including notice and cure periods)
 - Restrict (or enjoin) channel contract revisions, product-line withdrawals, territory modifications, addition of new channel partners, etc.
 - Regulate (or mandate) equipment repurchase
 - Invalidate contractual “waiver” of statutory obligations
 - Mandate warranty obligations to end users
 - Regulate pricing and advertising practices





“What are the differences between distributors, dealers, franchisees, etc.?”

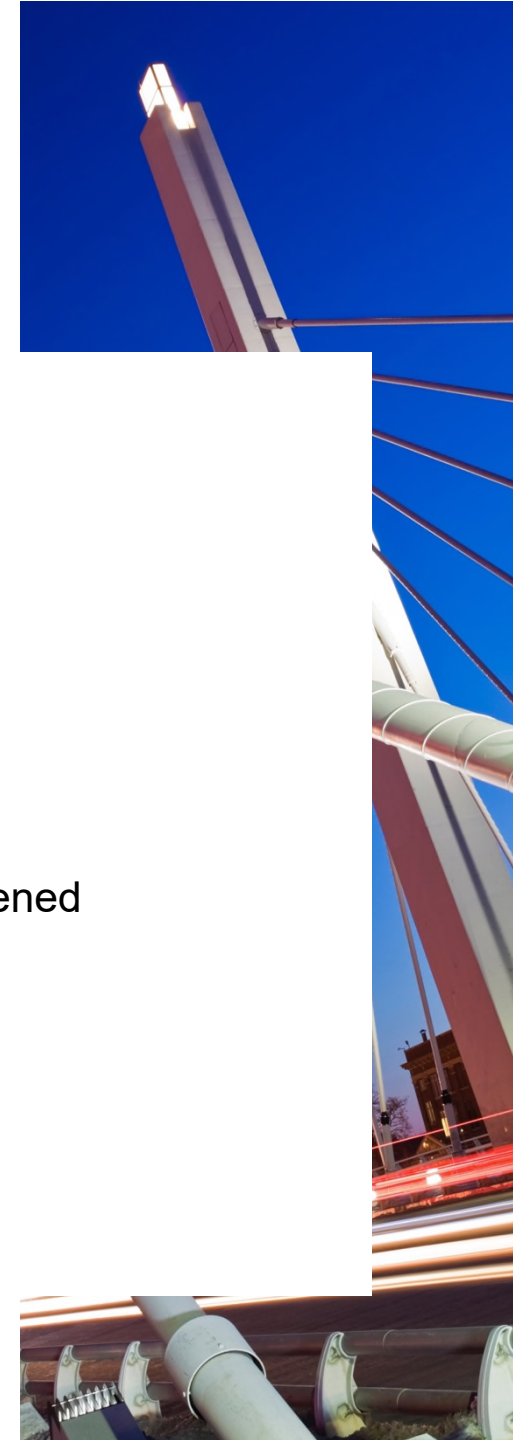
“What are the differences between distributors, dealers, franchises, etc.?”

- Terminology is key...but can be confusing
- Are your channel partners
 - Distributors?
 - Dealers?
 - Franchisees?
 - Sales representatives?
 - End users?
- Why does this matter?

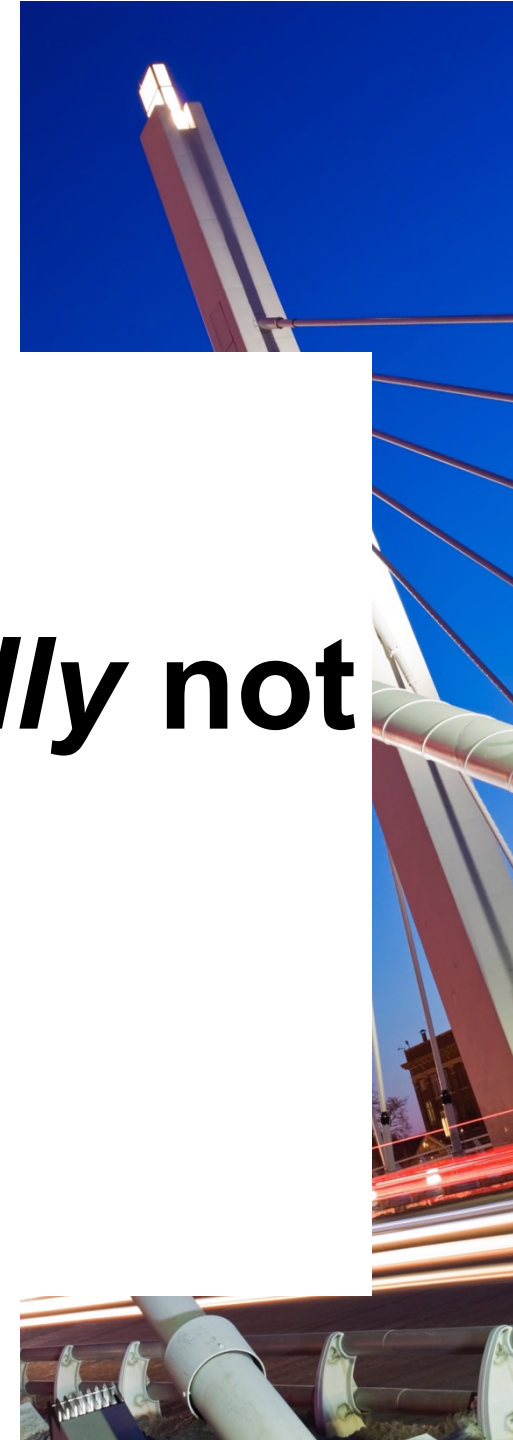


Definitional Differences

- Dealers vs. Distributors
 - Who can claim protection under relevant state statutes?
 - May be interchangeable, but may depend on to whom the channel partner sells your products
 - See Minn. Motor Veh. Sale & Distrib. Act, Minn. Stat. § 80E.01 *et seq.*
- Franchisees vs. Dealers vs. Distributors
 - Each is a partner who buys and resells products, but there are important differences
 - Franchisees generally receive more protection – and usually (but not always) must meet heightened definitional threshold
 - See New Jersey Franchise Practices Act, NJ Stat. Ann § 56:10-1 *et seq.*
- Sales Representatives vs. All of the Above
 - No buy-resell relationship, but still with statutory risk
 - See Min. Stat. 325E.37

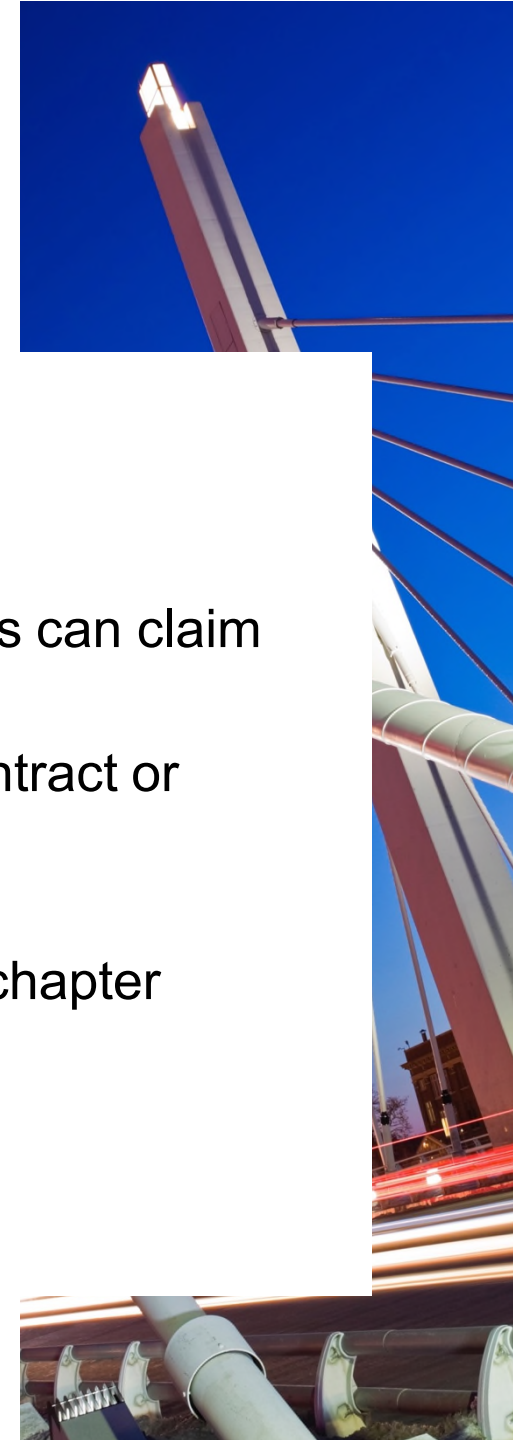


“Can dealer/franchise laws *really* not be waived?”



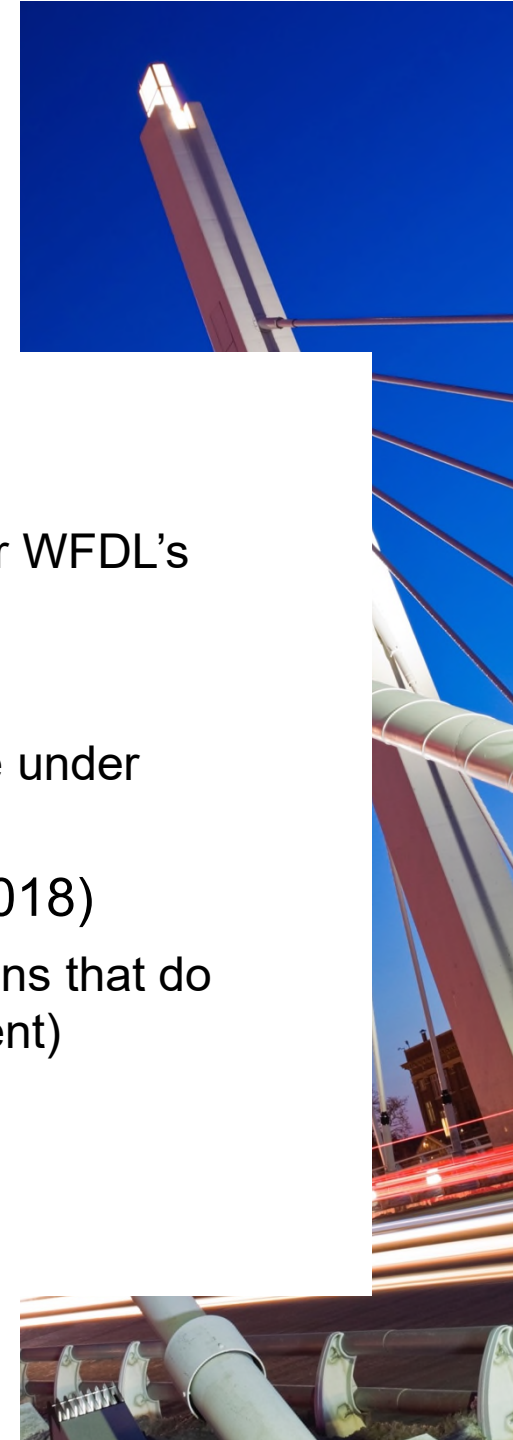
“Dealer/franchise laws *really* cannot be waived?”

- What is an “anti-waiver” provision?
 - Invalidates attempts to avoid state statutes by contract
 - Legislative policy decision to ensure state dealers, distributors, and franchisees can claim protection
- “The effect of this chapter may not be varied by contract or agreement. Any contract or agreement purporting to do so is void and unenforceable to that extent only.”
Wis. Stat. § 135.025(3)
- “An attempted waiver of a provision of this chapter or of the application of this chapter is void.”
Tex. Bus. & Comm. Code § 57.003



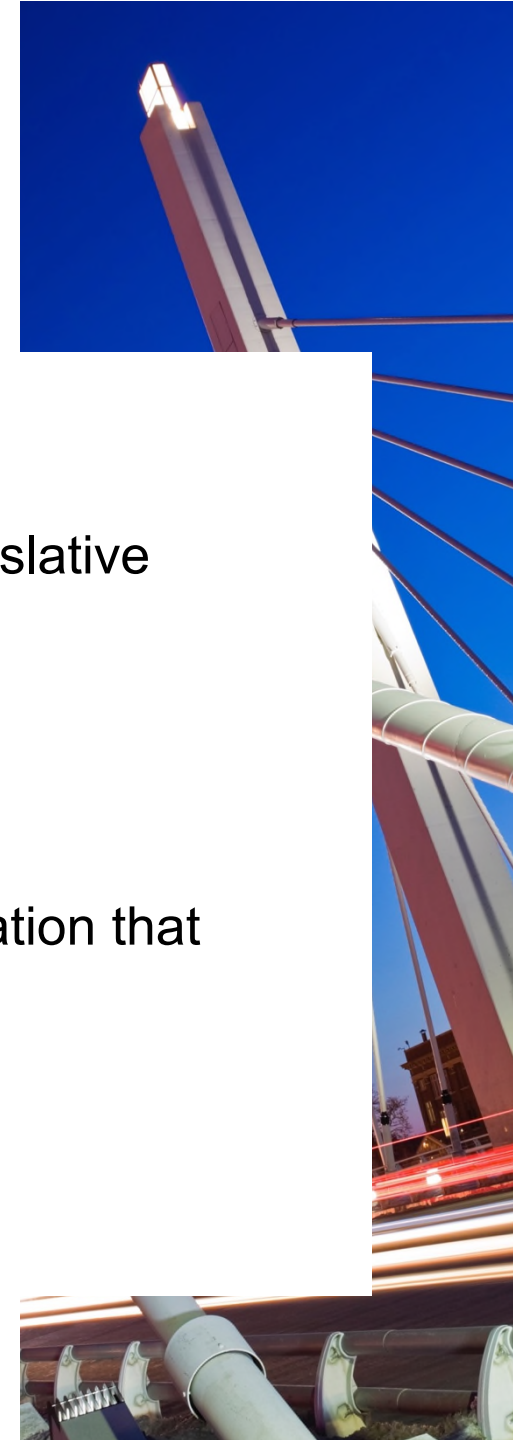
Anti-waiver Provisions

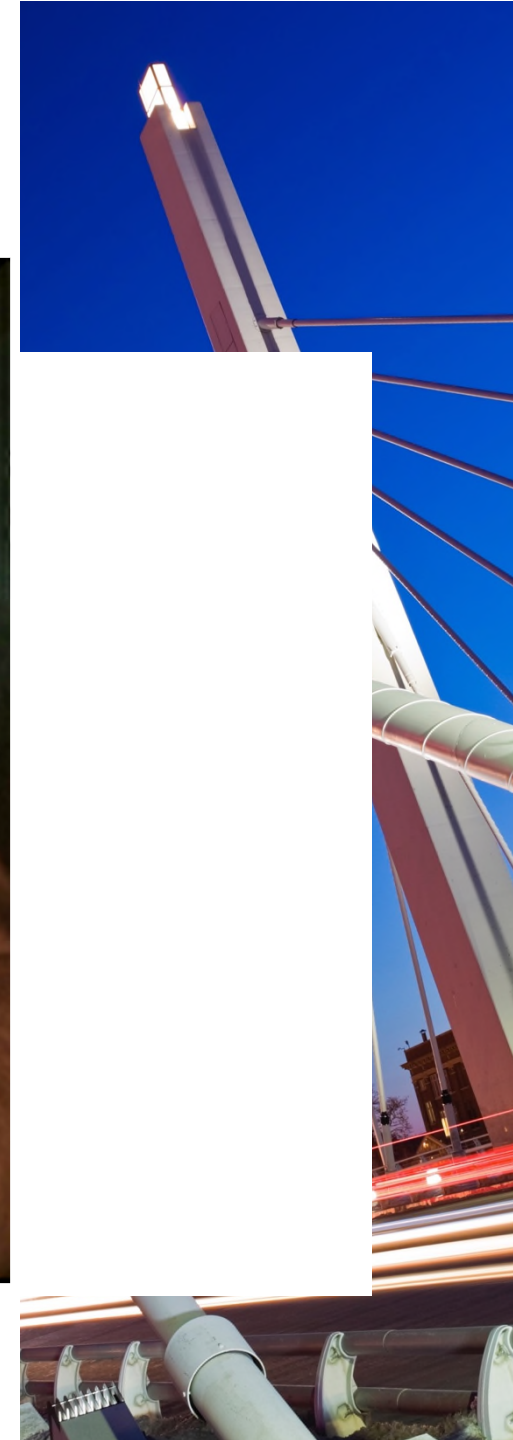
- *Bush v. National School Studios, Inc.*, 139 Wis. 2d 635 (Wis. 1992)
 - Contractual choice-of-law provision selecting Minn. law void and unenforceable under WFDL’s anti-waiver statute
- *Capital Equip., Inc. v. CNH America, LLC*, 471 F. Supp.2d 951 (D. Ark. 2006)
 - Contractual limitation of liability excluding lost-profit damages void and unenforceable under AFPA’s anti-waiver statute
- *Lawmen Supply Co. of N.J., Inc. v. Glock, Inc.*, 330 F. Supp.3d 1020 (D. N.J. 2018)
 - Attempted enforcement (and even mere presence) of contractual termination provisions that do not comply with the NJFPA (e.g., shortened notice period, no “good cause” requirement) constitute actionable violations of NJFPA under anti-waiver statute



Anti-waiver Provisions (cont.)

- Not all anti-waiver provisions are created equal
- To understand anti-waiver provisions, it helps to understand the underlying legislative policy
 - The “superior bargaining power” and “mom and pop shop” myths
- Where they exist and are broad, they override your contract
 - This includes material commercial terms
- Inflection point comes when terminating or modifying relationship (and the litigation that follows)
 - Entry is easy. Exit is more difficult. Anti-waiver provisions amplify that difficulty.
 - Investigate before you enter the relationship. Tailor your contract accordingly.





“What are the *pros* of exclusivity?”



“What are the *pros* of exclusivity?”

- What is exclusivity?
 - Contractual right to exclude
 - Need not be geographic
 - Customer, market segment, product line, service, etc.
- Drafting Tip: distribution agreements must expressly address exclusivity
 - “*exclusive*” must appear somewhere in the contract, ordinarily in appointment clause
- Manufacturers tend to default to non-exclusivity
 - “Good cause” + exclusivity = unreasonable business risk
 - Instead of proving good cause, rather utilize the “die on the vine” approach
 - Belief that it gives them flexibility – BUT AT WHAT COST?



Pros of Exclusivity

- Cons of non-exclusivity? Permission to free-ride
 - In non-exclusive channels, distributors engage in “intra-brand” competition
 - Price erosion, lowered esteem, decreased effort by good distributors
 - Race to the bottom
- Pros of Exclusivity: addresses the free-rider problem
 - Induce competent and aggressive distributors to make investments in capital and labor required for products unknown to consumers
 - Signals high quality, luxury, premium
 - Limits intra-brand competition, which is often on price
 - Alternative to MAP/Colgate
 - Avoids RPA problems

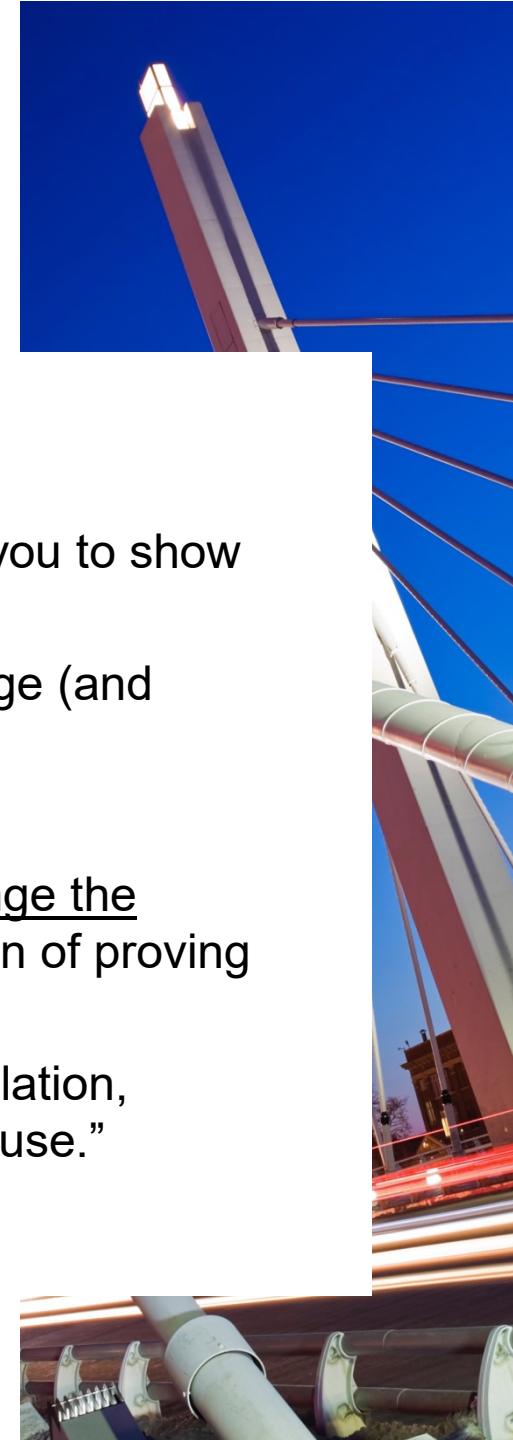


“What qualifies as a ‘substantial change in competitive circumstances’?”



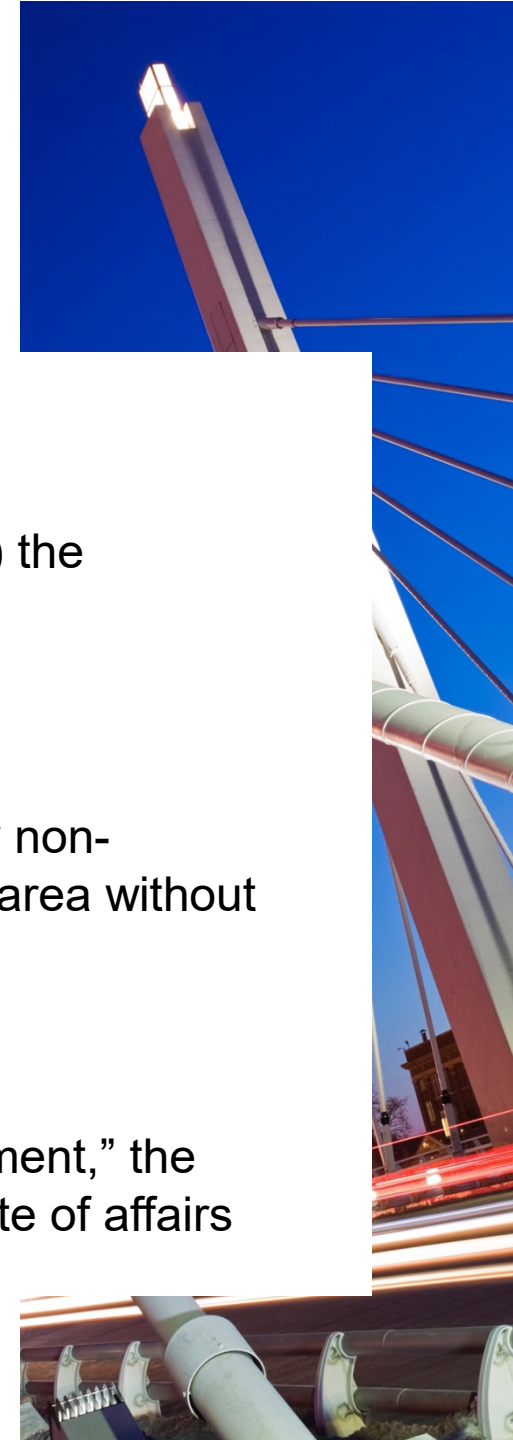
“What qualifies as a ‘substantial change in competitive circumstances’?”

- Why do you care?
 - Making a change to the way you do business with your channel partner may require you to show “good cause”
 - And your channel partner could potentially secure an injunction prohibiting your change (and recover attorneys’ fees)
- State-specific inquiry
 - **Wisconsin:** “No grantor . . . may terminate, cancel, fail to renew or substantially change the competitive circumstances of a dealership agreement without good cause. The burden of proving good cause is on the grantor.” Wis. Stat. § 135.03
 - **Iowa:** “A supplier shall terminate a dealership agreement for equipment . . . by cancellation, nonrenewal, or a substantial change in competitive circumstances only upon good cause.” Iowa Code § 322F.2



“Substantial Change in Competitive Circumstances”

- The legal nuances:
 - Does the statute prohibit a substantial change to the competitive circumstances of (1) the “dealership agreement” or (2) the “dealer” or “dealership.”
 - The more common approach is (1), but a few states do follow (2)
- This distinction is significant:
 - “The courts have held repeatedly that when a dealership agreement provides for only non-exclusive dealership rights in an area, a grantor may assign additional dealers to the area without violating [the WFDL].”
 - *Wisconsin Compressed Air Corporation v. Gardner Denver*, 571 F. Supp. 2d 992 (W.D. Wis. 2008)
 - *i.e.*, where a statute refers to the competitive circumstances of the “dealership agreement,” the question is whether the agreement has been changed, not the dealer’s real-world state of affairs



“Substantial Change in Competitive Circumstances” (cont.)

- What business decisions could this impact?
 - Withdrawing a channel partner’s exclusivity
 - Modifying product-line availability
 - Curtailing authorized territories
 - Appointing additional channel partners within authorized territories
 - Altering pricing terms
 - Modifying defined performance/sales/inventory expectations

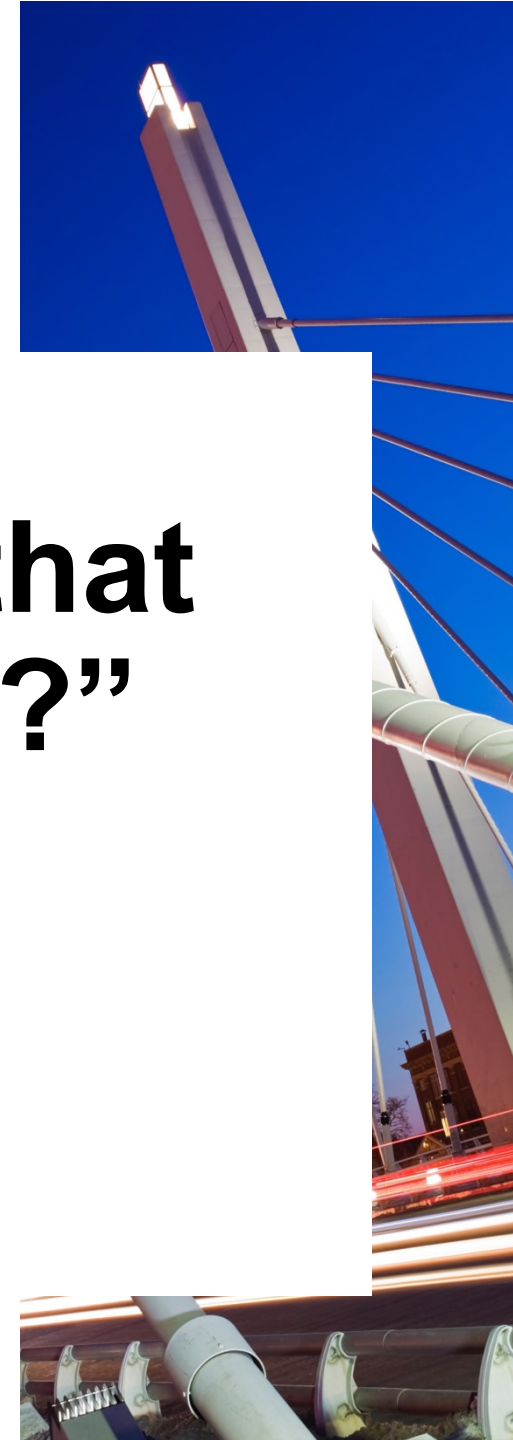


“Substantial Change in Competitive Circumstances”

- Practical Drafting Advice:
 - Include explicit reservations of rights in the applicable agreement
 - Which provisions?
 - Appointment: make non-exclusivity clear
 - Products, territory (esp. if non-exclusive), pricing, performance
 - Dealer obligations
 - Every provision?
 - No, potential “anti-waiver” issue
 - See *Girl Scouts Manitou Council, Inc. v. GSUSA*, 700 F. Supp. 2d 1055 (7th Cir. 2010) (explaining that, carried to its logical conclusion, the approach could effectively gut the protections of the WFDL)



“What are the kinds of fees that trigger franchise regulation?”



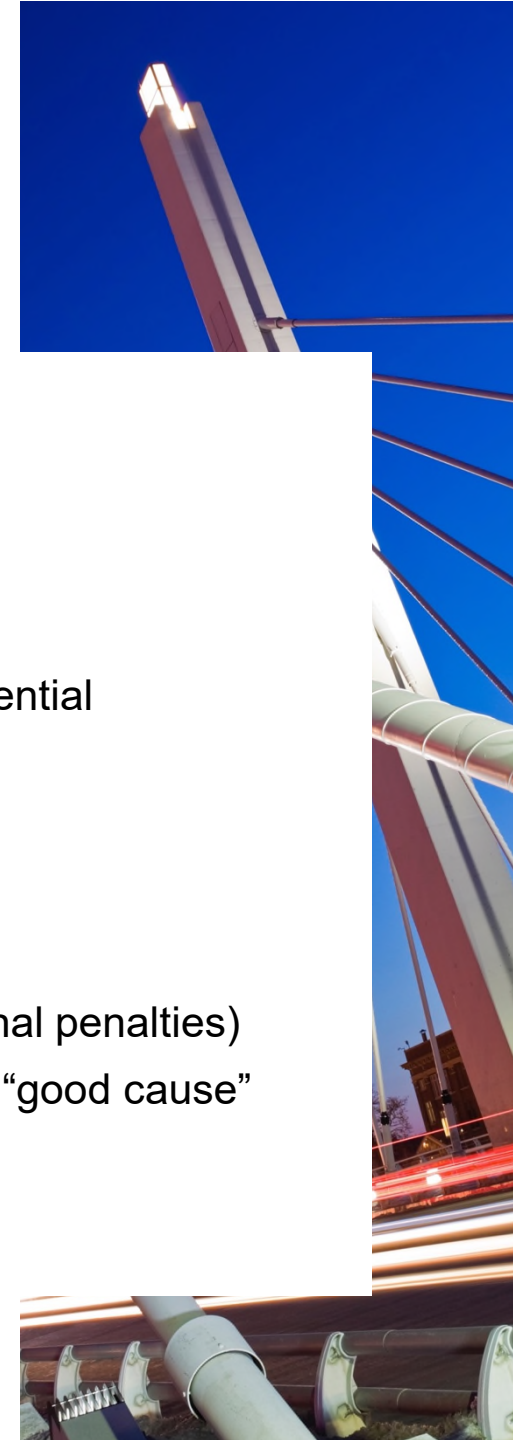
“What are the kinds of fees that trigger franchise regulation?”

- The “Accidental Franchise” Problem
 - It doesn’t matter if:
 - “Everyone in our industry does it this way.”
 - “Our contract expressly says it’s not a franchise.”
 - “We only use sales reps—they don’t buy and resell our products.”
 - “They use their own trade name, not ours.”
 - “They sell other products and services beyond ours.”
 - “This just doesn’t ‘look’ like a franchise to me.”
 - What does matter: (1) trademark license; (2) some control over marketing/business/operations; (3) franchise fee (indirect or otherwise)



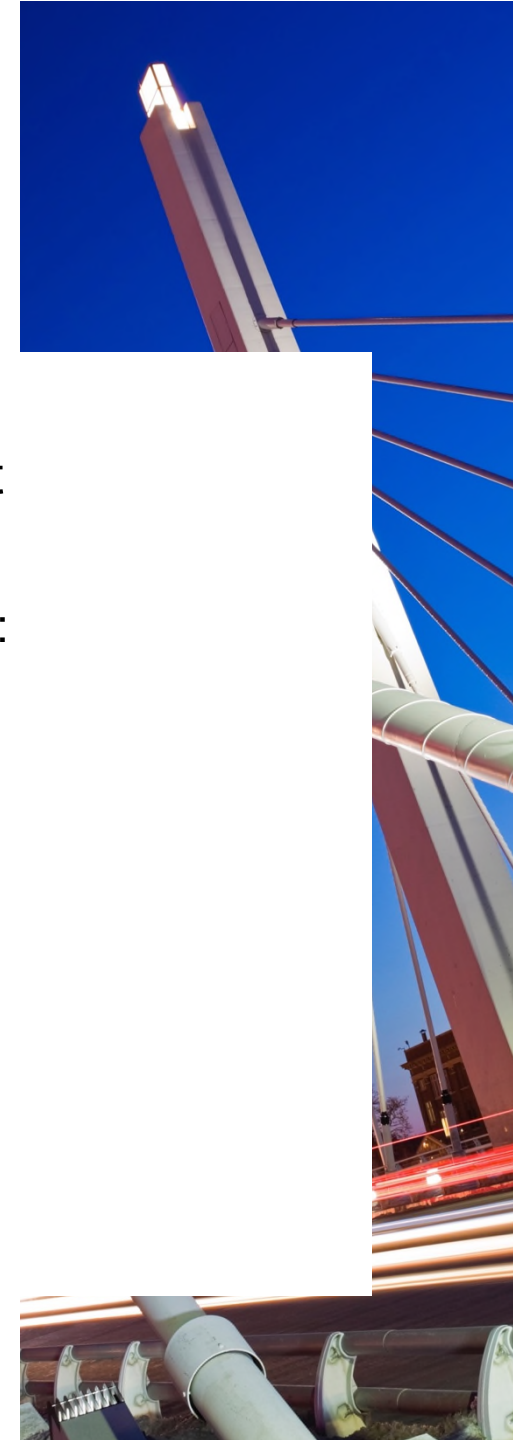
Accidental Franchises

- Why does it matter to you?
 - Heavily regulated relationship
 - FTC Rule
 - Pre-sale and annual disclosures, including public disclosure of financial statements, confidential settlements, etc.
 - State laws
 - Additional disclosure obligations
 - Substantive obligations (venue provisions, choice-of-law, anti-waiver, etc.)
 - Private causes of action for violating disclosure obligations (damages, civil penalties, criminal penalties)
 - Private causes of action for “substantial changes,” terminations, and non-renewals without “good cause”
 - With injunctive relief and attorneys’ fees



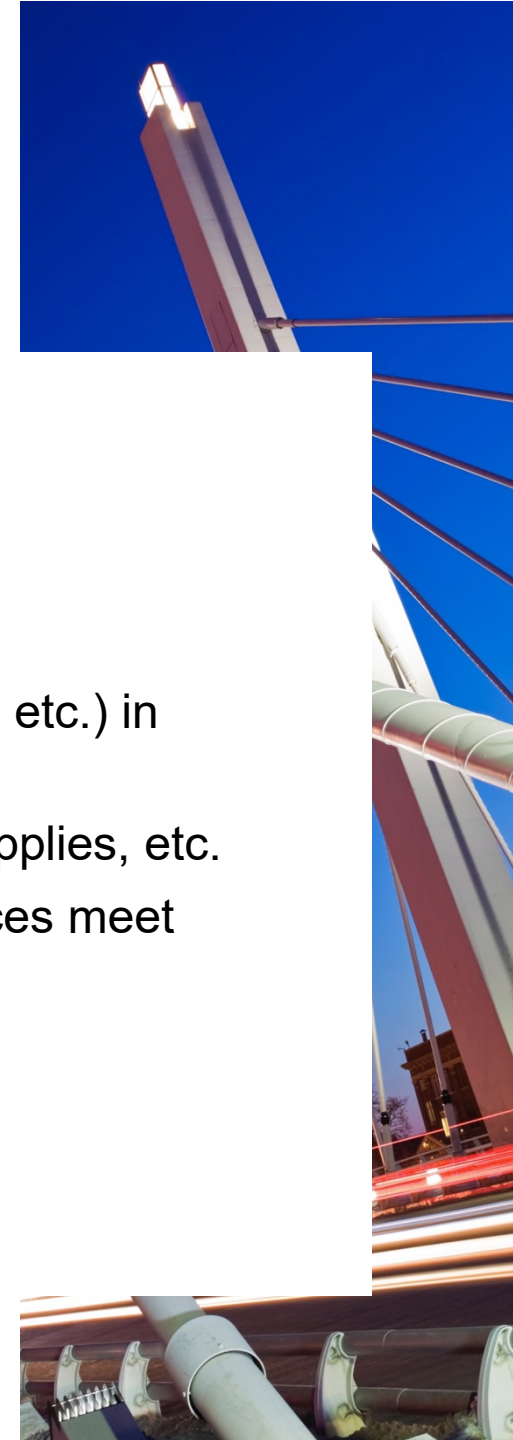
Accidental Franchises (cont.)

- The “franchise fee” element is both the easiest to avoid and the hardest to spot
 - The amount varies depending on the law
 - Upfront, “direct” franchise fees are easy to spot. “Indirect” franchise fees are thornier:
 - License fees and royalties
 - Equipment or real property lease payments
 - Advertising payments
 - Inventory purchase requirements exceeding reasonable quantity or price
 - Training fees
 - Consulting or management fees
 - Security deposits
 - Payment for manuals or promotional materials



Accidental Franchises (cont.)

- Trademark license element is nearly impossible to avoid
- Control over marketing is possible, but no bright line creates uncertainty
- You can avoid “franchise fee” element:
 - Include real costs (e.g., training costs, marketing materials, manuals, consulting fees, etc.) in price of goods
 - Identify potential alternative sources of ancillary, non-resalable products like tools, supplies, etc.
 - Allow channel partners to identify alternative sources of supply if the alternative sources meet your standards

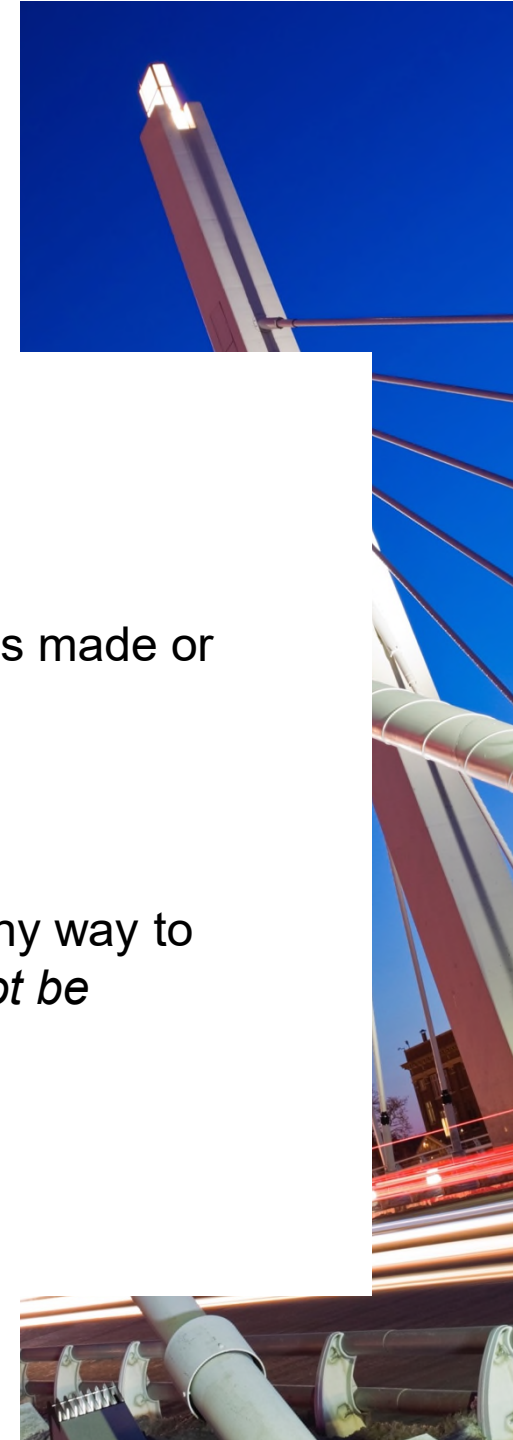




“If I’m a manufacturer selling through distributors, how does *my* warranty bind an end-user?”

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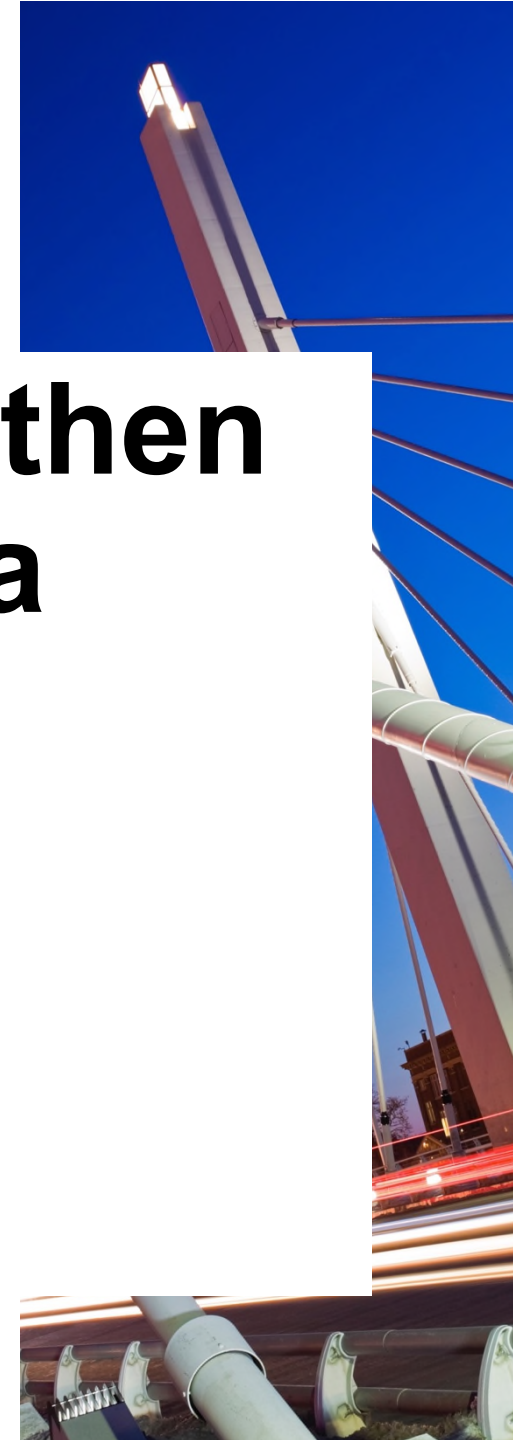
- Involves the UCC, so assume a labyrinth of case law
- Warranty:
 - UCC § 2-313: Any affirmation of fact, promise, description, sample, or model, which is made or becomes “basis of the bargain” creates an express warranty
 - “Basis of the bargain” = reliance
- No privity? No matter.
 - See UCC § 2-313 cmt. 2: “The warranty sections of this Article are not designed in any way to disturb those lines of case law growth which have recognized that warranties *need not be confined either to sales contracts or to the direct parties to such a contract.*”



Broader Point on Warranties – Make Them Stick

- Don't rely on lack of privity; rather, draft a proper *express* warranty
 - Disclaim implied warranties
 - Conspicuous—add it to distribution agreement, same should be in Ts & Cs
 - Next to the LLC (disclaiming all but direct damages), and limit remedies
 - Repair or replacement only
 - Only goes so far: UCC says can't limit remedies for personal injury
 - Indemnification of distributor, but distributor indemnifies manufacture for *ultra vires* promises
- **Require the distributor to convey the express warranty to the purchaser**
 - If multi-tier, obligate the distributor to obligate the dealer

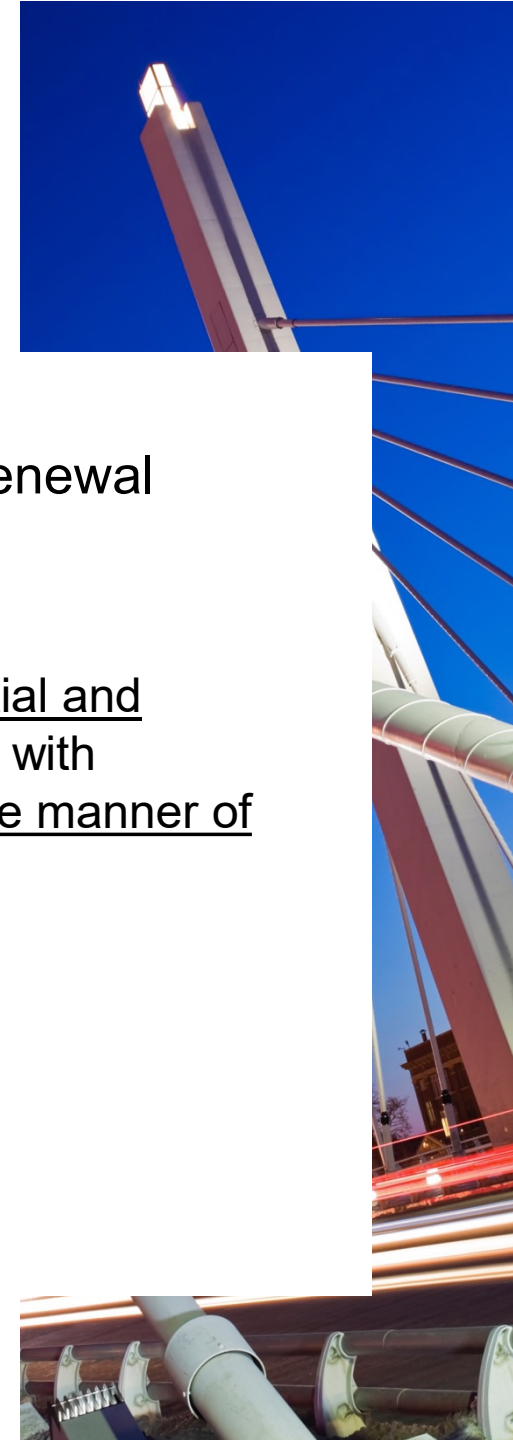




**“If I don’t have “good cause” then
how long am I stuck with a
distributor?”**

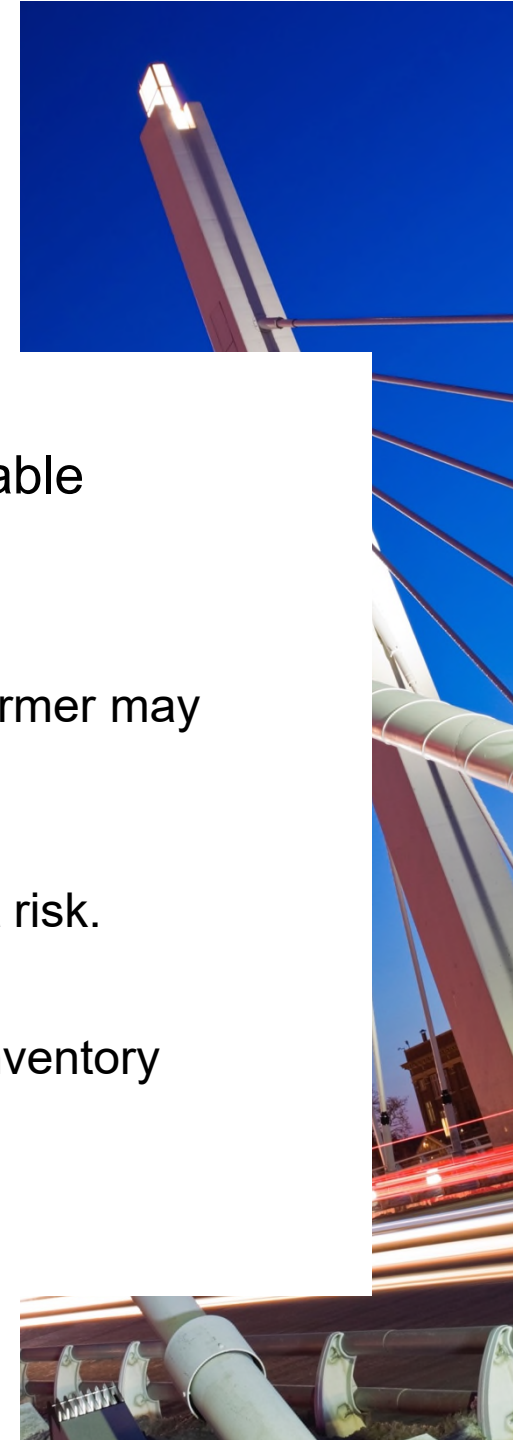
“If I don’t have “good cause” then how long am I stuck with a distributor?”

- Many state dealer/distributor laws prohibit termination, cancellation, **and** non-renewal without “good cause”
- What is “good cause”?
 - **Wisconsin:** “Good cause” is failure by the dealer “to comply substantially with essential and reasonable requirements . . . which requirements are not discriminatory as compared with requirements imposed on other similarly situated dealers either by their terms or in the manner of their enforcement.”
- This creates an “evergreen contract” problem

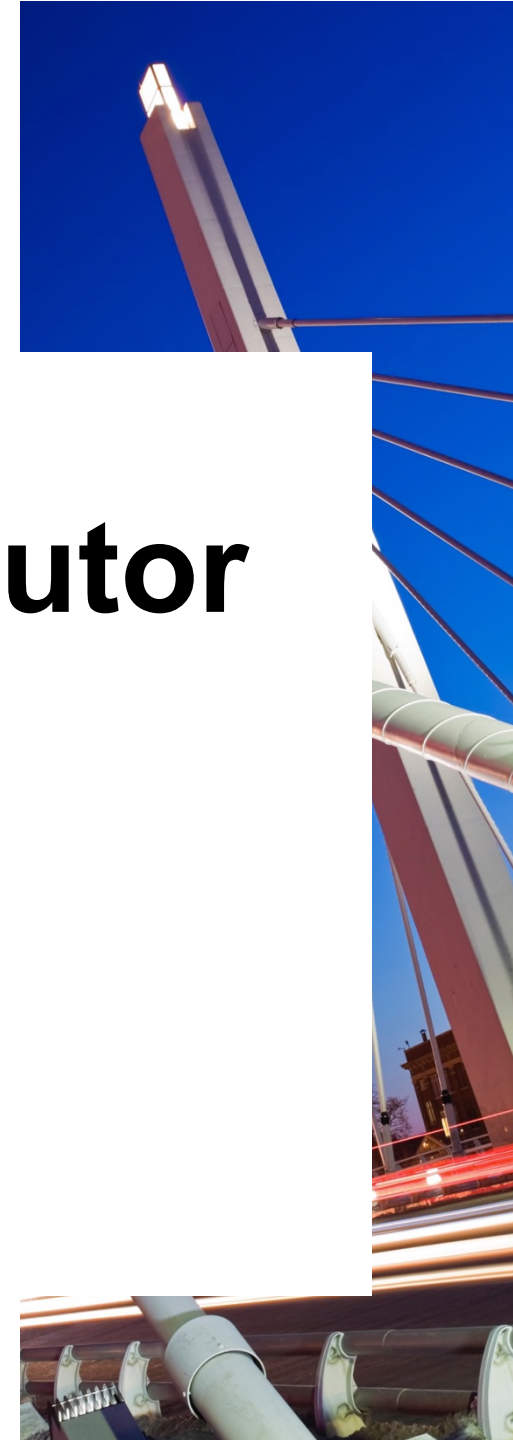


Ending the Relationship without “Good Cause”

- Without traditional “good cause,” you have a challenge, but it’s not insurmountable
- Consider your alternatives:
 - Appointment of additional representation in territory
 - Avoids disruption. Addresses loss of market share. Ensures coverage. Underperformer may walk away.
 - Voluntary termination
 - Avoids risk of termination claims. Faster transition. Less disruption. Limits market risk.
 - “Stay” termination to investigate dealer sale of business
 - Limits out-of-pocket costs. Doesn’t set precedent. Saves face for dealer. Avoids inventory repurchase issues. Ensures motivated incoming dealer.



“What do we do about distributor consolidation?”



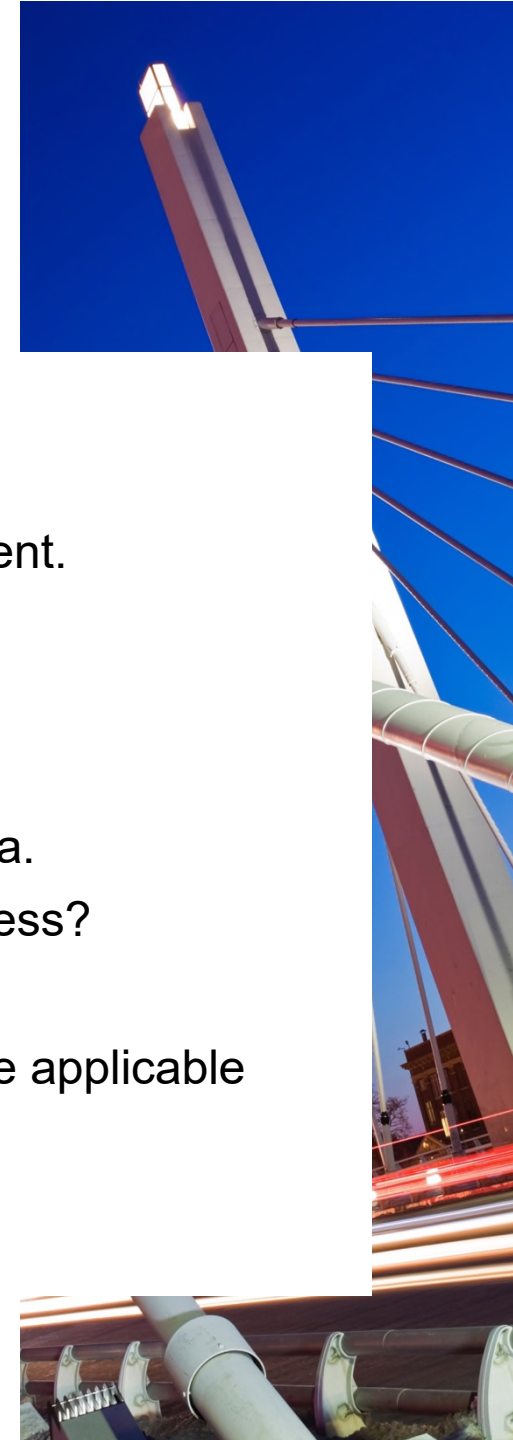
“What do we do about consolidation?”

- Dealer/distributor consolidation is not new, and it will continue
 - It’s not all bad
 - Large resellers can be a boon to your network:
 - Stronger financially
 - Have more refined marketing practices
 - Often can better predict market changes/customer needs
 - But you must separate the wheat from the chaff before the consolidation event



Channel Partner Consolidations

- How to evaluate a proposed consolidation?
 - First, can you do anything to prevent it? Have this right memorialized in your agreement.
 - Notice of proposed transfer. Approval rights (state law may dictate logistics).
 - Paper the record
 - Be reasonable in your assessment
 - What do you normally require of existing/prospective dealers? Use the same criteria.
 - Can you articulate why the transfer would be “substantially detrimental” to your business?
 - Avoid the appearances of an “arbitrary” denial
 - Some states specify factors that cannot be considered in denial decision. Know the applicable state law!





“Is the non-compete in my Distribution Agreement even enforceable?”

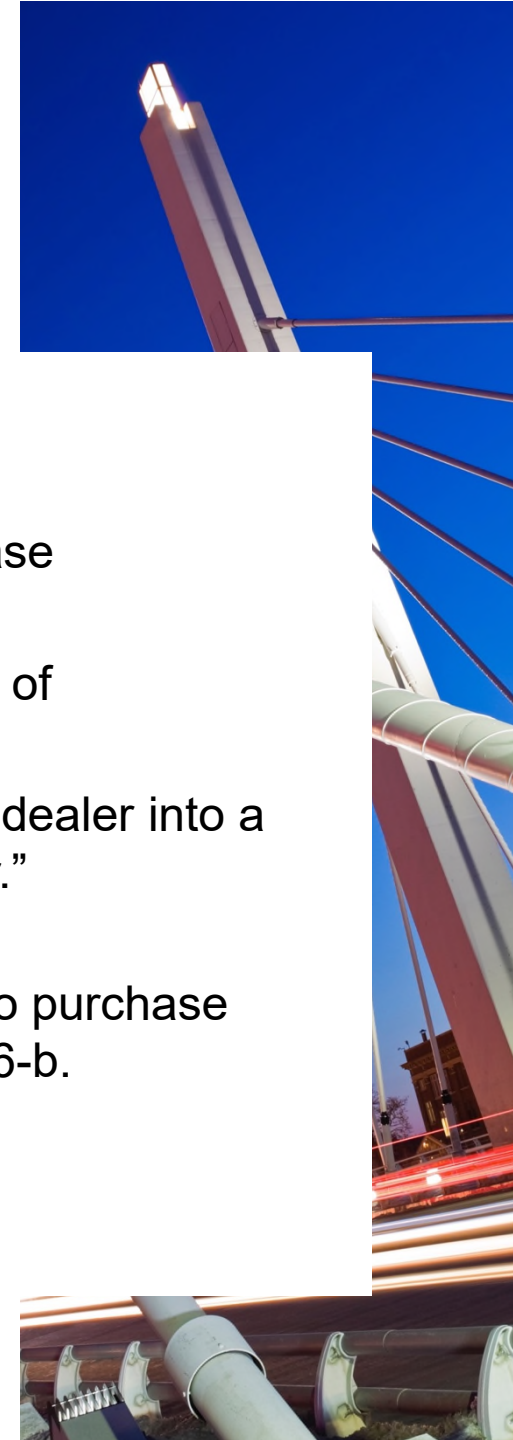
“Is the non-compete in my Distribution Agreement even enforceable?”

- Law developed in context of employer/employee relationship. Often state- and circumstance-specific.
 - Generally, similar rules apply to supplier/dealers, supplier/sales rep, and franchisor/franchisee
 - Common law can be fairly antagonistic to these “restraints on trade”
 - Federal antitrust laws can come into play (with all the risk those impose on suppliers)
 - Crafting enforceable non-compete is not impossible
- An enforceable non-compete is:
 - Ancillary to the relationship
 - Relates to a protectable interest, and
 - A reasonable restraint in light of that interest



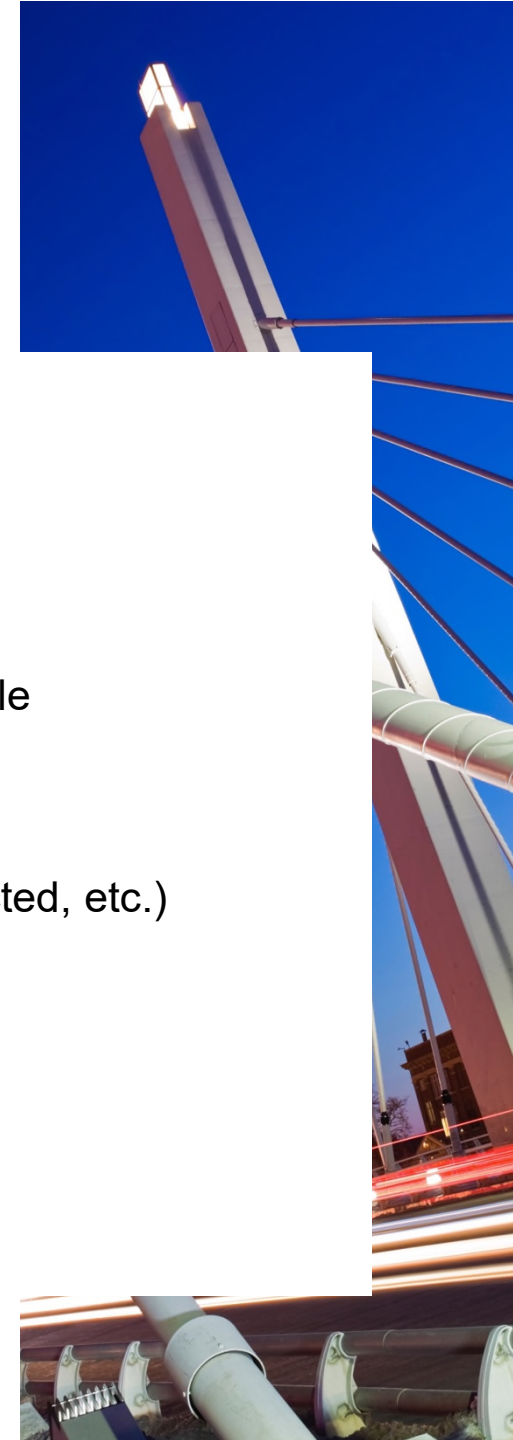
Non-Competes in Distribution Agreements

- An aside on the impact of state dealer laws and exclusive sales contracts:
 - **California:** prohibits taking any action “[t]o coerce any dealer into a refusal to purchase equipment manufactured by another supplier.” Cal. Bus. & Prof. Code § 22902(k)
 - **Florida:** prohibits preventing “dealer from...holding a dealership contract for the sale of competing product lines or makes of equipment.” Fla. Stat. § 686.413(3)(j)
 - **Minnesota:** prohibits heavy/utility equipment supplier from “coerc[ing] an equipment dealer into a refusal to purchase the equipment manufactured by another equipment manufacturer.” Minn. Stat. § 325E.0682(b)(2)
 - **New York:** prohibits farm equipment supplier from compelling “any dealer to refuse to purchase equipment from another supplier” (with limited exceptions). N.Y. Gen. Bus. Law § 696-b.



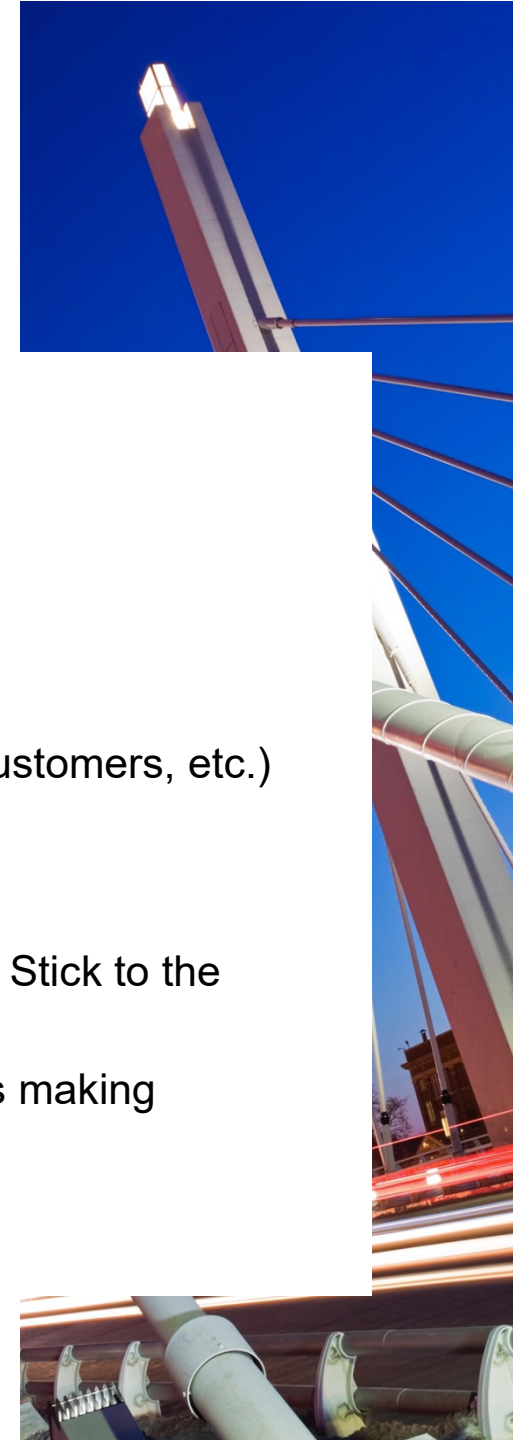
Non-Competes in Distribution Agreements

- Crafting an enforceable non-compete:
 - Identify and clarify your “Protectable Interests”
 - Confidential Information
 - Confidential information doesn’t usually mean “trade secret,” but it can’t be publicly available
 - Identify the information you are sharing with your dealer that is truly sensitive
 - Define that information as “confidential and proprietary”
 - Actually restrict access to that information (only to dealers not customers, password protected, etc.)
 - Customer Goodwill



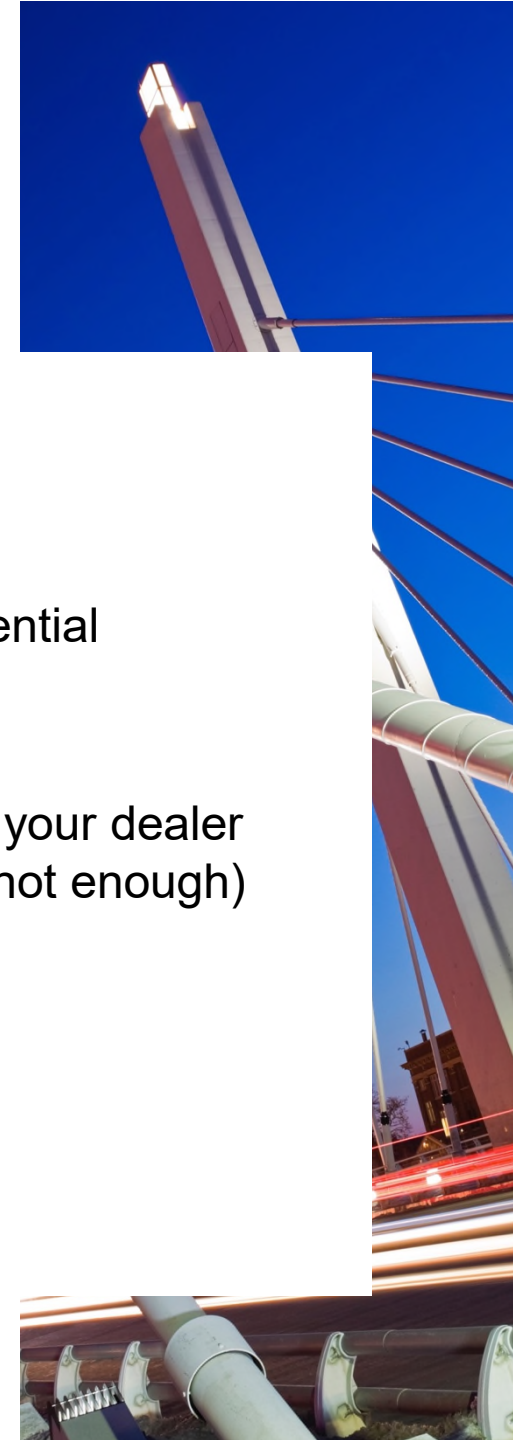
Non-Competes in Distribution Agreements

- Crafting an enforceable non-compete:
 - Reasonable Time and Territory
 - Time
 - Varies widely. For post-term restrictions, up to 1 year ok; 1 to 2 years is stickier.
 - Best practice to have specific justification (life cycle of confidential info; buying pattern of customers, etc.)
 - Territory
 - Two ways to define: (1) geographical description or (2) customer specific
 - Geographic works for dealer with many customers with comparatively small purchases. Stick to the territory dealer actually services
 - Customer specific is better (and is easy to craft for dealers with defined set of customers making larger purchases). Wisconsin and Illinois prefer this



Non-Competes in Distribution Agreements

- Crafting an enforceable non-compete:
 - Reasonable Activity
 - Should only restrain dealer from doing something that would cause it to use confidential information or customer good will
 - *E.g.*, soliciting customers about which dealer had information and/or actually serviced
 - Can't impose post-term restriction on, *e.g.*, working in R&D for a competitor unless your dealer had access to confidential information that impact R&D (customer lists/pricing info not enough)



Thank you.



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