DISTRIBUTION CONTRACTS

Outline

by Andre R. Jaglom[*]

I. *Methods of Distribution; Scope of Checklist*

There are many ways for a supplier to bring its products or services to market. It may sell directly through employees to the ultimate user. It may sell through commission sales agents who do not take title. It may sell to independent wholesalers or distributors. It may establish franchises that operate semi-independently under the supplier's trademarks. The alternative methods are limited only by the supplier's imagination and business and legal practicalities. However, once the channel of distribution is selected, other issues remain. For example, the supplier may license manufacturing methods or other technology to the distributor for a royalty, allowing the distributor to produce the product. The supplier may allow the distributor to use the supplier's trademarks, or require the distributor to develop its own marks.

This outline does not provide a detailed analysis of the special concerns raised by franchise agreements, trademark and technology licenses, protection of trade secrets and the like, but serves instead as a checklist which outlines the issues to be considered in the preparation of a basic distribution agreement.

One other caveat is in order. To properly prepare an effective distribution contract, a thorough understanding of the business mechanics of the client's distribution operation is critical. Counsel must understand not only the legal environment in which the client will operate, but also how the product will flow from the supplier to the ultimate consumer, how payment will flow back, what the salesmen actually will do, how returns of defective or unsold goods will be dealt with, the roles to be played by supplier, distributor and retailer in marketing, advertising and service, and the myriad other details which are critical to the distribution of products and services and which, therefore, must be addressed in the distribution contract. The careful practitioner should beware of "form" agreements, for there are no "form" clients. Different products, different services, different suppliers, and perhaps even different markets, all must be dealt with in different ways.

II. *Written vs. Oral Agreements*

A. *Generally.* In the absence of business or legal factors militating against a written agreement, as discussed below, it is generally in the interest of both parties to have a written distribution contract. Without a written agreement, there will be no recorded definition of the respective rights and obligations of the supplier and of the distributor, a circumstance often leading to business misunderstandings. If those misunderstandings become sufficiently great, one or both parties may deem it necessary to terminate the relationship or to take legal action to determine the parties' respective rights. The absence of a written agreement renders those rights unclear and thus more costly to litigate. In some states, a statute of frauds may preclude enforcement of an oral agreement entirely.[1] In other jurisdictions, a jury

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1 *See, e.g., D & N Boening, Inc. v. Kirsch Beverage, Inc.*, 99 A. 2d 522, 471 N.Y.S.2d 299 (2d Dep't), *aff'd*, 63 N.Y.2d 449, 483 N.Y.S.2d 164 (1984); *see* also Abrams *v. Unity Mutual Life Ins. Co.*, 237 F.3d 862 (7th Cir. 2001) (applying New York law, denied an agent's claim of unjust enrichment based on the agent's services to the insurer in reliance on an oral promise and an

may be permitted to infer an implied contract from conduct where none was intended.[2] Moreover, the parties will be left to the vagaries of state statutory and case law, which vary widely, on such issues as the supplier's right to terminate.

Assuming that a written agreement is deemed appropriate, counsel should resist the inevitable pressure from the client's sales force to begin selling to the candidate distributor before the agreement is signed, for the very act of selling may vest certain rights in the distributor under state law.[3] The existence of a written agreement does not necessarily resolve all issues, however. For example, the Fourth Circuit has held that, under South Carolina law, even where a contract provides a broad right to terminate without cause, such a termination is actionable "if the manner of termination is contrary to equity and good conscience," as where it is unconscionable or causes needless injury.[4] Moreover, some courts have held written contractual provisions to be superseded by oral representations.[5]

B. *Business Considerations.* If the written agreement being considered is one with an existing distributor of long standing with whom the relationship has never been reduced to a written agreement, it is important to consider the possible adverse business effects of suddenly asking good customers to sign formal contracts with detailed termination provisions. The advantages of a written agreement may not outweigh the cost of disrupting a smoothly functioning distributor relationship.

C. *Dealer Protection Statutes.* Many states have business franchise laws or other dealer protection statutes that restrict terminations (notwithstanding the terms of an agreement) or impose disclosure or registration requirements. Some of those statutes apply only to written agreements; relying on an oral arrangement may avoid the impact of these laws.[6] Moreover, if the proposed agreement is with an existing

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unsigned agreement; the agent's unjust enrichment claim was an improper effort to circumvent the statute of frauds because it was based on the same promise and sought the same relief as an otherwise barred contract claim; had the agent presented a basis for valuing his services independent of the unenforceable contract, summary judgment might have been denied).

2 *See, e.g., Famous Brands, Inc. v. David Sherman Corp.*, 814 F.2d 517 (8th Cir. 1987).

3 *See* discussion in III and IV below.

4 *deTreville v. Outboard Marine Corp.*, 439 F.2d 1099 (4th Cir. 1971); *but see Puretest Ice Cream, Inc. v. Kraft, Inc.*, 806 F.2d 323 (1st Cir. 1986) (no implied good cause or good faith requirement for termination when contract permits termination without cause); *Keeney v. Kemper Nat'l Ins. Cos.*, 960 F. Supp. 617 (E.D.N.Y. 1997) (same); *Premiere Wine & Spirits of South Dakota, Inc. v. E. & J. Gallo Wines*, 644 F. Supp. 1431 (E.D. Cal. 1986) (same).

5 *See, e.g., Ron Greenspan Volkswagen, Inc. v. Ford Motor Land Development Corp.*, 38 Cal. App. 4th 985 (1995) (permitting fraud claim notwithstanding merger clause disclaiming any representations, warranties or inducements beyond those in the written agreement); *Century 21 v. Home Town Real Estate Co.*, 890 S.W.2d 118 (Tex. App. 1995) (grant of second franchise in territory, as permitted by written agreement, but contrary to oral policy, was unconscionable under Texas Deceptive Practices Act); *McEvoy Travel Bureau, Inc. v. Norton Co.*, 408 Mass. 704, 563 N.E.2d 188 (Mass. 1990) (giving effect to oral assurances that contractual termination provision was meaningless and relationship was long-term); *see also Commercial Property Investments, Inc. v. Quality Inns International, Inc.* , 938 F.2d 870 (1991) (finding oral representations supported claim of fraud despite contractual disclaimer of reliance on any such representations); *A.J. Temple Marble & Tile, Inc. v. Union Carbide Marble Care, Inc.*, 162 Misc.2d 941, 618 N.Y.S.2d 155 (Sup. Ct. N.Y.Co. 1994), *aff'd*, 214 A.D.2d 473, 625 N.Y.S. 904 (1st Dep't 1995), *modified on other grounds*, 87 N.Y.2d 574, 640 N.Y.S.2d 849 (1996) (oral representations supported claim of violation of franchise disclosure law despite contractual disclaimer of reliance on any such representations). *But see, e.g., Traumann v. Southland Corp.*, 842 F. Supp. 386 (N.D. Cal. 1993) (refusing to enforce oral promise that was contradicted by express written provision, but permitting good faith and fair dealing claims to proceed); *Carlock v. Pillsbury Co.*, 719 F. Supp. 791, 815, 817, 829-30 (D. Minn. 1989) (N.Y. law) (barring oral modification of contract with provision prohibiting oral modification; parol evidence admissible to clarify ambiguous contract terms or to show fraud in inducement of contract, but reliance unreasonable where contradicted by express written disclaimer); *Rosenberg v. Pillsbury Co.*, 718 F. Supp. 1146, 1152-53 (S.D.N.Y. 1989) (Mass. law) (similarly).

6 *See, e.g.*, Miss. Code Ann. § 75-24-51; Neb. Rev. Stat. § 87-402; N.J. Stat. Ann. § 56-10-1 (West Supp. 1986); Va. Code

distributor whose relationship predates the applicable statute, one should consider the risk of losing the defense that the statute may not constitutionally apply to a pre-existing agreement. A new written agreement might be deemed a new contract to which the statute could apply, while a continuation of the pre-existing oral agreement might be viewed as outside the scope of the statute.[7]

State law on this subject varies widely. Some cases have held that the continuation of an at-will or order-to-order relationship after the enactment of a law in effect renews the contract and brings it within the new law, at least if there are material changes to the contract after the date of enactment.[8] In contrast, one court held that repeated renewal, after enactment of the Illinois Franchise Disclosure Act, of a contract predating its enactment did not bring the agreement within the Act[9] and another decision found no "significant alteration" of a contract sufficient to bring it within a new law where product lines were added to and removed from the relationship.[10] In a similar inconsistency, amendments to New York's beer franchise protection law were applied retroactively, because the parties could anticipate changes in the law affecting the heavily regulated alcoholic beverage industry,[11] while exactly the same contention was rejected in a decision refusing to apply the equivalent Kansas statute retroactively.[12]

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7 *See, e.g., Equipment Mfrs. Institute v. Janklow*, 2002 U.S. App. LEXIS 15769, BUS. FRAN. GUIDE (CCH) ¶ 12,381, (8th Cir. 2002) (restrictional on termination of farm equipment dealerships were unconstitutional impairment of contracts predating enactment of restrictions); *Cloverdale Equipment Co. v. Manitowac Engineering* Co., BUS. FRAN. GUIDE (CCH) ¶ 11,468, (6th Cir. 1998) (not for publication) (retroactive application of good cause requirement for termination would constitute unconstitutional impairment of contract); *Holiday Inns Franchising, Inc. v. Branstad*, 29 F.3d 383 (8th Cir.), *cert. denied*, 513 U.S. 1032, 115 S. Ct. 613 (1994) (retroactive application of franchise law unconstitutional; plaintiffs did not have notice of reasonable possibility of retroactive regulation) (affirming *McDonald's Corp. v. Nelson*, 822 F. Supp. 597 (S.D. Iowa 1993) (retroactive application of franchise law unconstitutional; legislative purpose of adjusting) balance of power between parties not a sufficient broad societal interest to justify impairment of existing contracts)); *Gulfside Distributors, Inc. v. Becco, Ltd.*, 985 F.2d 513 (11th Cir. 1993); *O.R.S. Distilling Co. v. Brown-Forman Corp.*, 972 F.2d 924 (8th Cir. 1992); *Rolec, Inc. v. Finlay Hydroscreen USA, Inc.*, 917 F. Supp. 67 (D. Me. 1996); *Louis Glunz Beer, Inc. v. Martlet Importing Co., Inc.*, 864 F. Supp. 810 (N.D. Ill. 1994) (change from master distributor status to normal distributor, and from subdistributor to distributor, materially altered contract, bringing it within dealer protection statute); *Larco Distributing, Inc. v. Latrobe Brewing Co.*, BUS. FRAN. GUIDE (CCH) ¶ 9774, 1990 WL 168702 (D. Kan. 1990); *Sound Move Autoplaza, Inc. v. Nissan Motor Co., Ltd.*, BUS. FRAN. GUIDE (CCH) ¶ 9399, 1989 WL 50797 (E.D.N.Y. 1989); *Heublein, Inc. v. Dep't of Alcoholic Beverage Control*, 237 Va. 192, 376 S.E.2d 77 (Va. Sup.Ct. 1989); *Rudolph Rosa v. Latrobe Brewing Co.*, 347 Pa. Super. 551, 500 A.2d 1194, 1199-1200 (Pa. Super. 1985); *but see Garal Wholesalers, Ltd. v. Miller Brewing Co.*, 193 Misc. 2d 630, 752 N.Y.S. 2d 679 (Sup. Ct. N.Y. Co. 2002) (retroactive application of beer franchise law's termination restrictions was constitutional because supported by public purpose and a reasonable accommodation between public interest and contractual expectations); *see generally* M. O'Hara, *Retroactive Application of State Franchise Termination Laws*, FRAN. L.J., Winter 1988, at 3.

8 *See*, e.g., Va. Code, Tit. 4, § 4-118.58 (1989). *See also Mays v. Massey-Ferguson, Inc.*, 1990 U.S. Dist. LEXIS 10245, 1990 WL 80673, 1990-1 TRADE CAS. (CCH) ¶ 69,028, BUS. FRAN. GUIDE (CCH) ¶ 9617 (S.D. Ga. 1990) ("significant, as opposed to minor, changes in the contractual relationship between the parties constitutes a renewal" bringing contract within new law); *cf. David Golper Co., Inc. v. Cargill, Inc.*, 1995 WL 366481, BUS. FRANCH. GUIDE (CCH) ¶ 10,715 (Wis. Ct. App. 1995) (not for publication) (incorporation of distributor after effective date of Wisconsin Fair Dealership Law was implied new agreement making statute potentially applicable).

9 *Jake Flowers, Inc. v. Kaiser*, 2002 WL 31906688, BUS. FRAN. GUIDE (CCH) ¶12,478 (N. D. Ill. 2002).

10 *O.R.S. Distilling Co. v. Brown-Forman Corp.*, 972 F.2d 924 (8th Cir. 1992)(addition and deletion of product lines was not renewal or amendment of oral agreement predating franchise law, so franchise law does not apply).

11 *Garal Wholesalers, Ltd. v. Miller Brewing Co.*, 193 Misc. 2d 630, 752 N.Y.S. 2d 679 (Sup. Ct. N.Y. Co. 2002).

12 *Larco Distribution, Inc. v. Latrobe Brewing Co.*, 1990 WL 168702 (D. Kan. 1990)

III. *Effect on Termination Rights of Not Having Written Agreement*

If no written agreement or written provision governing termination exists, it becomes important to determine what the parties' rights will be should the supplier decide to terminate the relationship.

A. *Common Law Contract Rules.* In the absence of an applicable dealer protection law, some courts have held that an order-to-order relationship, with no express or implied agreement as to duration, may be discontinued by the supplier at any time.[13] Courts have also imposed requirements of continuation of the relationship for a reasonable period, reasonable notice of termination, or good cause for termination.[14] In addition, state law may impose requirements of good faith and commercial reasonableness,[15] although these will not generally be applied to contravene a contractual right to terminate without cause.[16]

B. *Recoupment.* A number of states apply the doctrine of recoupment to prohibit termination of a contract of indefinite duration until the distributor has been given a reasonable period of time to recoup its investment in the distributorship.[17] This suggests that suppliers may want to include a representation by

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13 *See, e.g., Smoky Mountains Beverage Co. v. Anheuser-Busch, Inc.*, 182 F. Supp. 326, 331-33 (E.D. Tenn. 1960) (under Tennessee law, the evidence did not show an express or implied contract, and the relationship was terminable at will, with or without cause); *Scanlan v. Anheuser-Busch, Inc.*, 388 F.2d 918, 920 (9th Cir. 1963) (under New Mexico law, the arrangement was held to amount to a contract terminable at will without cause); *Kraftco Corp. v. Kolbus*, 1 Ill. App. 2d 635, 274 N.E.2d 153 (1971) (a distributorship contract with no termination provision was terminable at will without notice).

14 *See, e.g., Sofa Gallery, Inc. v. Stratford Co.*, 872 F.2d 259 (8th Cir. 1989) (contract of no definite duration terminable on reasonable notice sufficient to allow distributor to recoup investment); *Copy-Data Systems v. Toshiba America*, 755 F.2d 293 (2d Cir.), *cert. denied*, 474 U.S. 825 (1985) (oral distribution agreement terminable only after reasonable duration and upon reasonable notice); *Ag-Chem Equip. Co., Inc. v. Hahn, Inc.*, 480 F.2d 482, 487 (8th Cir. 1973) (under Minnesota Law, "as is generally true elsewhere," a contract of indefinite duration is terminable at will upon reasonable notice); *Italian & French Wine Co. of Buffalo, Inc. v. Negociants U.S.A., Inc.*, 842 F. Supp. 693 (W.D.N.Y. 1993) (under New York law, contract with no express termination date implies that performance is to continue for reasonable time and may be terminated only upon reasonable notice); *Des Moines Blue Ribbon Distribs., Inc. v. Drewrys Ltd.*, 256 Iowa 899, 129 N.W.2d 731 (1964) (required contract to continue for a reasonable time, with reasonable notice of termination); *Utility Appliance Corp. v. Kuhns*, 393 Pa. 414, 143 A.2d 35 (1958) (when the duration of a franchise agreement is not fixed, the agreement is effective for a reasonable time and thereafter is terminable at will upon proper notice).

15 *See, e.g., Burger King Corp v. C.R. Weaver*, 169 F.3d 1310 (S.D. Fla. 1999) (no action for breach of implied covenant of good faith and fair dealing in absence of breach of express contract term; implied covenant cannot vary terms of express contract). *Carvel Corp. v. Baker*, 79 F. Supp. 2d 53 (D. Conn. 1997) (sales to supermarkets might violate duty of good faith, notwithstanding supplier's contractually reserved right, in supplier's "sole and absolute discretion," to sell in territory via the same or different distribution channels); *Mays v. Massey-Ferguson, Inc.*, 1990 U.S. Dist. LEXIS 10245, 1990 WL 80673, 1990-1 TRADE CAS. (CCH) ¶ 69,028, BUS. FRAN. GUIDE (CCH) ¶ 9617 (S.D. Ga. 1990) (termination after refusal to buy unwanted goods might constitute bad faith termination); *Atlantic Richfield Co. v. Razumic*, 480 Pa. 366, 390 A.2d 736 (1978); *see also Carlo C. Gelardi Corp. v. Miller Brewing Co.*, 502 F. Supp. 637 (D.N.J. 1980) (under New Jersey law, an implied covenant of good faith and fair dealing is present in every contract), *aff'd*, Nos. 82-5616, 82-5127, and 82-5218 (3d Cir. 1983); *but see Orthonet v. A.B. Medical, Inc.*, 990 F.2d 387, 392 (8th Cir. 1993) (no independent claim for breach of implied covenant of good faith and fair dealing, independent of underlying breach of contract claim under Minnesota or Florida law, where underlying promise was barred by statute of frauds); *Alan's of Atlanta, Inc. v. Minolta Corp.*, 903 F.2d 1414, 1429 (11th Cir. 1990) (implied covenant of good faith and fair dealing is not independent term subject to breach apart from any other, but merely modifies meaning of explicit terms to prevent *de facto* breach when performance is maintained *de jure*); *Tanner v. Church's Fried Chicken, Inc.*, 582 So.2d 449, 452 (Ala. Sup. Ct. 1991) (duty of good faith is "directive, not remedial" and not actionable without breach of specific contract terms); *cf. Amoco Oil Co. v. Burns*, 496 Pa. 336, 342, 437 A.2d 381, 384 (1981) ("the duty of good faith and commercial reasonableness is used to define the franchisor's power to terminate the franchise only when it is not explicitly described in the parties' written agreements"); *see generally* 1 A. CORBIN, CONTRACTS § 96 (1963) (an agreement calling for successive performances but of indefinite duration was held to be terminable at the will of either party on reasonable notification).

16 *See, e.g., Devery Implement Co. v. J.I. Case Co.*, 944 F.2d 724, 728-29 (10th Cir. 1991); *Hoff Supply Co. v. Allen-Bradley Co., Inc.*, 768 F. Supp. 132, 135 (M.D.Pa. 1991), and cases cited at n.4 above.

17 *See, e.g., Sofa Gallery, Inc. v. Stratford Co.*, 872 F.2d 259 (8th Cir. 1989); *Ag-Chem Equipment Co., Inc. v. Hahn, Inc.*, 480

the distributor that it already had all the resources necessary to perform the agreement, or an acknowledgment that termination is permitted at any time and that any "investment" is made voluntarily by the distributor with that understanding.

C. *Other Theories.* It is worth noting that under some circumstances, a terminating supplier may find itself liable for a business tort.[18] In addition, some courts have invoked the doctrines of fraud, breach of fiduciary duty or unconscionability in the termination context.[19]

D. *Uniform Commercial Code.* Section 2-309 of the U.C.C. governs the performance and termination of continuing agreements of indefinite duration for the sale of goods. A contract that provides for successive performances but is of indefinite duration is considered valid for a reasonable time, but unless otherwise agreed, it may be terminated at any time by either party.[20] However, unless termination is to occur on the happening of an agreed event, termination of a contract by one party requires reasonable notification.[21] The U.C.C. also imposes a general good faith standard.[22]

E. *Antitrust Concerns.* Section 1 of the Sherman Act may apply when a refusal to deal or termination is the result of concerted action, whether horizontal or vertical.[23] Section 2 of the Sherman Act may apply if the supplier deals in scarce products or has monopoly power.[24] The law seems to be moving towards favoring defendants in termination cases, at least since *Continental T.V. Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977).[25]

F.2d 482, 486 (8th Cir. 1973); *see also Bartolomeo v. S.B. Thomas, Inc.*, 889 F.2d 530 (4th Cir. 1989); *Tractor and Farm Supply, Inc. v. Ford New Holland, Inc.*, 898 F. Supp. 1198 (W.D. Ky. 1995).

18 For the elements of these torts, *see, e.g., Unijax, Inc. v. Champion Int'l, Inc.*, 683 F.2d 678, 687 (2d Cir. 1982) (tortious interference with prospective business relations); *Shaitelman v. Phoenix Mut. Life Ins. Co.*, 517 F. Supp. 21, 24-25 (S.D.N.Y. 1980) ("prima facie tort" under New York law); *Robbins v. Ogden Corp.*, 490 F. Supp. 801, 810 (S.D.N.Y. 1980) (tortious interference with contracts).

19 *Carter Equip. v. John Deere Indus. Equip.*, 681 F.2d 386, 388-90 (5th Cir. 1982) (fiduciary duty); *Call Carl, Inc. v. BP Oil Corp.*, 554 F.2d 623 (4th Cir.), *cert. denied*, 434 U.S. 923 (1977) (fraud), cf. *Arnott v. Am. Oil Co.*, 609 F.2d 873, 883-84 (8th Cir. 1979), *cert. denied*, 446 U.S. 918 (1980) (fiduciary duty); *Beehive Beer Distributing Corp. et al. v. Wisdom Import Sales Company, Inc. et al.* (E.D.N.Y. 2000) (fiduciary duty may arise out of a confidential relationship where one party assumes control and responsibility); *Koehler Enterprises, Inc. v. Shell Oil Co.*, BUS. FRAN. GUIDE (CCH) ¶ 10,252 (D. Md. 1993) (franchise relationship alone does not create fiduciary duty, but additional dealings between parties may do so; where franchisee was less sophisticated and "vulnerable", existence of fiduciary duty is question of fact); *Pickering v. Pasco Marketing, Inc.*, 303 Minn. 442, 228 N.W.2d 562 (1975) (applying the principle of unconscionability to limit a contractual termination right, focusing on circumstances surrounding the termination); *Shell Oil Co. v. Marinello*, 120 N.J. Super. 357, 294 A.2d 253 (Super. Ct. Law Div. 1972), *modified and aff'd*, 63 N.J. 402, 307 A.2d 598, *cert. denied*, 415 U.S. 920 (1974) (same); *Ashland Oil, Inc. v. Donahue*, 159 W. Va. 463, 223 S.E.2d 433 (1976) (same); *see generally* RESTATEMENT (SECOND) OF TORTS §§ 762-774A (1977) (where refusal to deal and intentional interference with contractual relations are present). *But see Crim Truck & Tractor Co. v. Navistar Int'l Transportation Corp.*, 30 Tex. Sup. Ct. J. 647 (6/12/91) (no fiduciary duty in franchise relationship); *Power Motive Corp. v. Mannesman Demag Corp.*, 617 F. Supp. 1048 (D. Colo. 1985) ("vast majority" of jurisdictions hold no fiduciary duty in franchise context) and cases cited therein.

20 Uniform Commercial Code § 2-309(2).

21 *Id.* § 2-309(3).

22 *Id.* § 1-203.

23 *See, e.g.* 2 J. VON KALINOWSKI, ANTITRUST LAWS AND TRADE REGULATION § 6C.02[2] (1986).

24 *See, e.g., id.* § 6C.02[3].

25 *See e.g., Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988); *Monsanto Co. v. Spray-Rite Serv.*

F. *State Statutes.* In some states, a termination may invoke state consumer and businessperson protection statutes.[26] In addition, many states have business franchise laws with very broad scope that restrict the termination of distributors notwithstanding any contractual provisions. These are discussed further in section IV below.

IV. *State Franchise Laws*

A. *Generally.*

1. *Breadth of Coverage.* It is critical that counsel explore the applicability of any state business franchise law or other dealer protection statute. Some three-quarters of the states have general statutes regulating franchises, business opportunities or both. These are often applicable to a much wider variety of distribution arrangements than classic fast food or muffler type franchises.

2. *Types of Statutes.* Some of these laws require specified detailed disclosures and sometimes registration with state authorities.[27] (The Federal Trade Commission Rule on franchising, 16 C.F.R. Part 436, is similar.) Some statutes restrict the supplier's right to terminate the relationship or otherwise regulate the substantive nature of the relationship, such as the supplier's right to prohibit transfers or assignments and the supplier's freedom to increase prices without notice.[28]

3. *Special Industry Laws.* In addition to these general laws, many states have laws applicable to specific industries, such as petroleum products, motor vehicles, farm equipment, beer, wine and liquor and office equipment. Petroleum products and automobile dealers are also protected by federal statutes.[29]

B. *Applicability.*

1. "*Franchise" Laws.* The definitions of a "franchise" under state statutes and the FTC Rule follow a general pattern. First, there is usually a trademark element — either a license to use the franchisor's trademark, service mark or the like,[30] or substantial association with such a mark[31] or, in some cases, the mere right to sell goods or services using the mark.[32] Second, there is usually a marketing element — either a community of interest between franchisor and franchisee in the marketing of goods or

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Co., 465 U.S. 752 (1984).

26 *See, e.g.*, Mass. Gen. Laws Ann. ch. 93A (West 1984 & 1986 Supp.); *see generally* Stadfeld, *Survey of State Little FTC Acts and Consumer Protection Statutes*, ABA FORUM COMMITTEE ON FRANCHISING FOURTH ANN. FORUM (Oct. 15-16, 1981).

27 *E.g.*, Calif. Corporations Code §§ 31000 *et seq.*; N.Y. Gen. Bus. Law §§ 680 *et. seq.*

28 *E.g.*, Calif. Bus. and Professions Code §§ 20000 *et seq.*; N.J. Rev. Stats. § 56:10-1 *et seq.*

29 15 U.S.C. §§ 1221 *et seq.* (automobile dealers); 5 U.S.C. §§ 2801 *et seq.* (motor fuel).

30 *See, e.g.*, Hawaii Rev. Stat. Tit. 26, § 482E-2.

31 *See, e.g.*, Calif. Corporations Code § 31005(a)(2).

32 *See, e.g.*, Mich. Comp. Laws § 445.1502(3)(b).

services,[33] or a marketing plan prescribed by the franchisor.[34] And third, there is often, but not always, a franchise fee element.[35]

2. *"Business Opportunity" Laws.* Another set of definitions applies to "business opportunity" laws, generally involving suppliers who (i) provide or help find locations for vending machines, racks or displays; (ii) purchase all products which the purchaser makes using supplies sold by it to the purchaser; (iii) guarantee that the purchaser will derive income exceeding the price paid or the seller will return the purchase price or repurchase any products, equipment or supplies; *or* (iv) will provide, upon payment of some minimum sum, a sales or marketing program which will enable the purchaser to derive income from the business opportunity. Unlike franchises, where the involvement of the franchisor's trademark is usually a necessary element, the business opportunity laws often *exempt* sales of business opportunities in conjunction with the licensing of a registered trademark.[36]

3. *Exemptions.* Various state statutes have a variety of exceptions for fractional franchises, suppliers with large net worth, and other situations too varied to explore here. The statutes, regulations and interpretive guides of relevant states should always be consulted.

C. *Substantive Restrictions*.

Most state franchise laws also regulate certain substantive provisions of the relationship between franchisor and franchisee, particularly with respect to termination. Such restrictions have generally withstood constitutional attacks, although one court has held such restrictions in a farm equipment dealer protection law violative of a state constitution's due process clause.[37] (That decision has since been reversed by constitutional amendment.)[38]

1. *Termination and Non-Renewal.* Of the states with franchise laws restricting termination rights, some, such as Mississippi, merely require that a specified minimum notice be given.[39] Most, however, in addition to requiring minimum notice and opportunity to cure, also require that "good cause" or "just cause" exist, not only for termination but also for non-renewal of a franchise. The statutory definition, if any, of such cause is often very narrow and generally does not include poor sales performance *per se*.[40] A number of definitions do define good cause to include the franchisee's failure to comply with reasonable requirements of the franchise agreement, and performance standards might qualify as such a requirement.

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33 *See, e.g.*, Minn. Stat. § 80C.01(4). An ordinary buyer-seller relationship, if of a continuing nature, may satisfy the "community of interest" requirement.

34 *See, e.g.*, Calif. Corporations Code § 31005(a)(1).

35 *See, e.g.*, California Business and Professions Code § 20001; Haw. Rev. Stat., Tit. 26, § 482E-2.

36 *See, e.g.*, California Civil Code § 1812.201; Florida Statutes, 1981, § 559.801.

37 *Mays v. Massey-Ferguson, Inc.*, 1990 U.S. Dist. LEXIS 10245, 1990 WL 80673, 1990-1 TRADE CAS. (CCH) ¶ 69,028, BUS. FRAN. GUIDE (CCH) ¶ 9617 (S.D. Ga. 1990) (holding restrictions on termination and other provisions of farm equipment dealer law violate Georgia due process clause by restricting freedom of contract in industry not affected with public interest) (overruled by constitutional amendment).

38 Ga. Laws of 1992, Resolution Act 125, approved May 6, 1992, ratified November 3, 1992.

39 *See, e.g.*, Miss. Code §§ 75-24-51 to 75-24-61.

40 *See, e.g.*, Minn. Stat. § 80C.14(b).

Moreover, many states require that, before termination occurs, the franchisee or distributor be given a specified period of time — often sixty or ninety days — in which to cure any deficiency.[41] "Curing" has been held not necessarily to require correction of a breach, but merely the taking of steps to avoid a recurrence. Thus a distributor who made out-of-territory sales in breach of a contractual provision was held to have cured the deficiency by ensuring that such sales did not recur.[42]

2. *Addition of Distributors.* Some state laws not only restrict termination and non-renewal but other diminutions of a franchise, such as the addition of other distributors or franchisor-owned outlets in the franchisee's area.[43]

3. *Other Substantive Restrictions.* Some state laws also restrict other aspects of the franchise relationship, such as barring or limiting restrictions on franchisee associations, restrictions on changes in management or ownership, requirements that goods or services be obtained from the franchisor, discrimination among franchisees in price, credit terms, services and the like, unreasonable performance standards, or increases in prices without notice.[44]

4. *Waiver of Rights.* Many statutes prohibit any waiver by the franchisee of its statutory rights.[45]

D. *Avoiding the Applicability of Franchise Laws.* The restrictions discussed above, as well as the detailed and burdensome disclosure and registration requirements of the FTC Rule and state franchise statutes, often make it desirable for a supplier to try to avoid falling within their scope. This can often be accomplished by the supplier structuring its distribution methods so as to fall outside the statutory definition of a "franchise" or "business opportunity." In most states with typical definitions, avoidance of *any* element of the definition will take the relationship outside the statute's scope. However, in New York, if a franchise fee is present, the statute applies if *either* the trademark element *or* the prescribed marketing plan element is met.

1. *Trademark Element.* If it is important that the distributor operate under the supplier's trademark, this element is difficult to avoid. Even if the distributor merely sells trademarked goods, the "substantial association" test of some state laws may be met, thereby satisfying the trademark element. In California, for example, so long as the mark is displayed to the distributor's customers, this element may be satisfied,[46] and under "community of interest" laws, the mere right to sell trademarked goods is sufficient.[47] In Indiana, a distributor's right to advertise itself as an "authorized distributor" for the brand was enough to satisfy the trademark element, even in the face of a prohibition on the use of the supplier's name and trademark.[48] In New Jersey, however, the statute applies only if the supplier's mark is used in

41 *See, e.g.*, Minn. Stat. §80C.14(3); 47 Pa. Stat. § 4-492 (19).

42 *McKeesport Beer Distributors, Inc. v. All Brand Importers, Inc.*, 390 Pa. Super. 627, 569 A.2d 951 (Pa. Super. 1990).

43 *See, e.g.*, Hawaii Rev. Stat. § 482E-6(2)(E); Ind. Code, Tit. 23, art. 2, Ch.2.7, § 1(2).

44 *See, e.g.*, 1981 Rev. Code of Wash. § 19.100.180; N.J. Rev. Stat. § 56:10-7; Rev. Stat. Neb. § 87-406; Ind. Code, Tit. 23, art. 2, Ch.2.7, § 1(2).

45 *See, e.g.*, Mich. Comp. Laws § 445.1527(d); Wis. Stat., Tit. XIV-A, § 135.025(3).

46 *See* State of California Guidelines for Determining Whether an Agreement Constitutes a "Franchise," *reprinted in* BUS. FRAN. GUIDE (CCH) ¶ 7558 at 12,350-51.

47 *See, e.g.*, Minn. Stat. § 80C.01(4).

48 *Wright-Moore Corp. v. Ricoh Corp.*, 908 F.2d 128, 135 (7th Cir. 1990).

such a way "as to create a reasonable belief on the part of the consuming public that there is a connection between the . . . licensor and licensee by which the licensor vouches, as it were, for the activity of the licensee."[49] The scope of the distributor's right to use the supplier's mark generally should be limited to the minimum extent necessary for proper operation of the business.

2. *Marketing Plan Prescribed in Substantial Part.* By avoiding specifying requirements or advice on how the distributor should operate its business, a supplier can avoid becoming subject to many state franchise laws. Prescription of a plan need not be express. It will be inferred if a sales program is suggested or recommended, even where there is no obligation on the franchisee to observe it.[50]

California's Guidelines describe factors to be considered in determining whether this requirement is met, including advertising that a marketing plan is available; use of exclusive territories; uniformity of prices and marketing terms; control over distributor payment and credit terms or warranties and representations; requirement of supplier approval of locations; use of trade names, advertising and signs; rules governing appearance of the distributor's business; employee uniforms; housekeeping rules; inspection and reporting procedures; and comprehensive promotional plans.[51]

3. *Franchise Fee.* In states with a franchise fee element (and under the FTC Rule), the franchise fee element often provides the most readily available way to avoid coverage. Most such states and the FTC Rule exclude bona fide wholesale prices from the definition of a fee. Care must be taken, however, not to require minimum inventory purchases or other purchases not required by the market, as these may constitute a fee, even if at bona fide wholesale prices. Similar exceptions may be available for equipment and supplies. The definitions of franchise fees in relevant statutes, regulations and interpretations should be examined closely in setting up any aspects of a distribution system in which money flows from the distributor to the supplier.

It may be possible to eliminate all flow of money from distributor to supplier. Consignment sales, for example, in which the supplier pays a commission to the distributor, but the distributor does not take title to the goods and so does not pay the supplier for them, may avoid coverage. The FTC has issued an advisory opinion that a consignment sale plan did not fall within the Rule.[52]

4. *Applicable Exceptions.* If any statutory exemptions exist, such as those dealing with a supplier's size or the percentage of a distributor's business the supplier's products will comprise, the underlying facts should be set forth in the agreement.

5. *Business Opportunity Laws.* If the distribution system contemplated involves vending machines, racks, or product displays, state business opportunity laws can generally be avoided by leaving the distributor entirely to its own devices in finding locations. In all cases where such state laws exist, representations as to the ability to derive income from the opportunity should be avoided or, better still, disclaimed, as should buy-back promises.

Even the avoidance of express representations as to income may be insufficient, however. Connecticut's Banking Commissioner's Office has interpreted that state's business opportunity law in an Advisory Interpretation dated August 24, 1981.[53] That interpretation states that, to fall within the statutory

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49 *Instructional Systems, Inc. v. Computer Curriculum Corp.*, 130 N.J. 324, 352-53, 614 A.2d 124, 139 (N.J. Sup. Ct. 1992).

50 *Id.*

51 California Guidelines, *supra*, at 12,348-49.

52 *Gull Industries, Inc.* (FTC Advisory Opinion, October 5, 1983) (reported in 45 A.T.R.R. (BNA) 573 October 13, 1983).

53 *Reprinted at* BUS. FRAN. GUIDE (CCH) ¶ 7699.

definition, a representation that the seller will guarantee that the purchaser will derive income in excess of the price paid for the opportunity must be express. The opinion goes on, however, to state that a representation that, upon payment of a specified sum, the seller will provide a sales or marketing program that will enable the purchaser to derive income in excess of the price paid for the opportunity need *not* be express. Rather, because "the derivation of profit is central to any sales or marketing program," no purchaser would enter into a business opportunity without the expectation of a profit. Thus, no express representation is necessary, and a disclaimer of any such representation will be "frowned on."

In light of this view, sellers in states with similar laws who do not wish to fall within their ambit should probably not only avoid representations regarding income and disclaim such representations, but also avoid representing that a sales or marketing program will be supplied.

V. *Contents of the Distribution Contract — Generally*

Once counsel determines that a written agreement is necessary and proper, it is important to define the client's objectives before beginning to draft. As noted, it is important to understand how the business works and what the client is trying to achieve, so as to determine the best way to achieve it.

A. *Supplier Objectives.* The supplier will want to establish a structure that will ensure satisfactory performance or allow the supplier to end the relationship. This will involve specifying as fully as possible exactly what it wants the distributor to do and trying to quantify acceptable performance levels, so that the supplier will be satisfied so long as the agreement's terms are met. All possible reasons for dissatisfaction should be determined, so that adequate termination rights can be provided. The supplier's expectations in areas like advertising, promotion and service should be specified.

B. *Distributor Objectives.* The distributor will want to define exactly what sort of support it will receive from the supplier in terms of advertising and promotion, delivery, and any support services, such as accounting or training. It will want to determine what performance levels are reasonable and appropriate to its market, so that it is not held to unreasonable levels of performance and will be protected so long as reasonable standards are achieved. It will want to consider what quantity and price guarantees it will need. Finally, it may want compensation for the value of its distribution rights in the event of termination or non-renewal by the supplier, at least in the absence of material breach by the distributor.

VI. *Contents — Definitions of Product*

The contract should specify whether the distributor has the right to buy the supplier's entire line or only specified products. The supplier may be given the right to reduce the range of products sold to the distributor, under certain specified circumstances. It is important to consider how broadly or narrowly to define the products, as well as the extent to which product characteristics may be changed. For example, a product definition tied to a trademark may leave a distributor without a product if the trademark is changed or a separate one adopted for new products. It is also necessary to decide whether to give the distributor an option or right of first refusal with respect to any new products the supplier may introduce in the future, or to require the distributor to handle such products. In addition, it may be important to specify whether different products or product lines are part of a single distribution agreement or are separable. In one case in which different product lines were included in separate product addenda, they were held to constitute separate franchises, so that the termination of one product line violated a state franchise law. This might not have been the case had the various product lines been part of a single franchise, since a substantial portion of the franchise would have continued.[54]

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54 *General Motors Corp. v. Gallo GMC Truck Sales, Inc.*, 711 F. Supp. 810 (D.N.J. 1989). *Contra Central GMC Inc. v. General Motors Corp.*, 946 F.2d 327 (4th Cir. 1991).

VII. *Contents — Definition of Territory*

A. *Where May this Distributor Sell?* The territory must be clearly defined if the areas in which the distributor may sell or the customers to whom it may sell are limited. The permissibility of territorial and customer restrictions is governed by a rule of reason, taking into account such factors as the supplier's market power, any anticompetitive effect on intrabrand competition (between distributors of the supplier's product), which must be compared with any alleged positive effect on interbrand competition (with products of other suppliers), and the importance of interbrand competition as a source of competitive pressure on price.[55] If such restrictions are imposed, not only should out of territory sales be prohibited, but also sales to those the distributor knows or has reason to believe will resell outside the territory (or those the supplier notifies the distributor it believes will do so), to prevent transshipping.

B. *May Others Sell in this Territory?* The distributor may be granted exclusive rights in the territory, or the supplier may sell to others.[56] The distributor may require the supplier to provide protection against "gray market" imports from other distributors outside the Territory. Another option is to require distributors selling outside their principal territory to pay a portion of their profits over to the distributor in whose territory the sale was made. The supplier may reserve the right to sell to certain types of customers (for example, "national accounts," governmental customers or military bases) directly. Some national retailers insist on purchasing directly from the manufacturer, so reserving the right to make such sales may be critical. In such situations, the distributor may receive compensation for those sales in the form of a per unit "invasion fee."

The supplier should consider its own long-term goals before granting an exclusive territory to a distributor, particularly in relation to the supplier's possible plans for direct marketing on the internet. One American Arbitration Association decision held that the establishment of a franchisee's exclusive territory precludes internet sales by the franchisor to customers located within the franchisee's territory.[57] (Another arbitration panel came to the opposite conclusion, finding H&R Block's internet offering of its tax preparation services did not unreasonably intrude on the franchisee's operations and so did not violate the exclusive territory provisions of the franchise agreement.)[58] Some state statutes for specific industries also preclude direct sales by suppliers on the internet, and the supplier should be aware of these state regulations when determining exclusive territories.[59]

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55 *See, e.g., Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977); *Graphic Products Distributors, Inc. v. Itek Corp.*, 717 F.2d 1560 (11th Cir. 1983). Note that state antitrust authorities often take a harder line on what territorial restrictions are permitted. *See, e.g., Abrams v. Anheuser-Busch, Inc.*, 673 F. Supp. 664 (E.D.N.Y. 1987), in which the New York Attorney General attacked territorial restrictions in the beer industry.

56 A supplier's express reservation of rights to sell to others has been held to defeat Puerto Rico dealers' claims that the supplier's sales to others had impaired its existing relationship in violation Law 75, Puerto Rico's strict Dealers' Act. *Graphics Supply, Inc. v. Polychrome Corp.*, BUS. FRAN. GUIDE (CCH) ¶ 11,192 (1st Cir. 1997) (not for publication); *Vulcan Tools of Puerto Rico v. Makita USA, Inc.*, 23 F.2d 564 (1st Cir. 1994).

57 *Emporium Drug Mart., Inc. of Shreveport v. Drug Emporium, Inc.*, AAA Case No. 71-114-00126-00(2000), , *reported at* BUS. FRANCH. GUIDE (CCH) ¶ 11,966.

58 *Matter of Arbitration between Franklin 1989 Revocable Family Trust and H&R Block, Inc.*, BUS. FRAN. GUIDE (CCH) ¶12,473 (December 31, 2002).

59 *See, e.g., Ford Motor Co. v. Texas Department of Transportation*, 106 F. Supp. 2d 905, 2000 U.S. Dist. LEXIS 11666 (2000) (W.D. Tex. 2000) (operation by Ford Motor Company of web site allowing prospective purchasers within the state of Texas to view previously owned vehicles and arrange for them to be viewed at a local dealer brought Ford within the statutory definition of a dealership, thereby violating the Texas law prohibiting a manufacturer from operating or controlling a dealership).

It is similarly noteworthy that a California court held that, despite the absence of an exclusive territory in a franchisee's franchise agreement, the franchisor's placement of other franchises in close proximity to the existing franchisee created a triable issue of fact as to whether the franchisor breached the implied covenant of good faith and fair dealing.[60]

VIII. ***Contents – Internet Distribution***

As internet distribution becomes more prevalent, suppliers need to make sure they are protected against unintended or unforeseen distribution of their product by providing for internet distribution methods and standards in their agreements with distributors. Suppliers who do not yet want their product marketed over the internet, but do not want to foreclose the possibility entirely for the future, may include a provision requiring their prior approval for a distributor to sell or advertise online, or to sell to those whom the distributor knows or has reason to believe will resell online. Without such a provision, a supplier wishing to limit internet distribution of its products is left to less direct alternatives, which may or may not be available depending on the circumstances, such as announcing a general policy of not dealing with dealers who distribute through the internet, refusing advertising support for internet sales, restricting the use of the supplier's intellectual property to print or traditional broadcast media, and limiting its warranty to exclude internet sales. Some products that can be transferred digitally may be distributed directly over the internet, such as software, audio and video materials, information databases and the like. In such cases, the supplier may readily choose to avoid distributors entirely.

If a supplier accepts distribution through on-line channels, it should set standards for internet distribution in its distribution agreements. Depending upon their concerns and their product, suppliers may limit internet distribution to products that do not require service or, alternatively, require distributors to arrange for a bricks and mortar distributor to provide any service needed. Products requiring extensive pre-sale education or demonstration may benefit from limitation of internet distribution, to avoid discount online sellers from free-riding on the efforts of bricks and mortar dealers who invest in such pre-sale efforts. Standards for website operation and customer service, such as a twenty-four hour hotline or response time standards for online inquiries, might be prescribed. A supplier should consider restricting the use of any domain name that makes use of or might be confused with the supplier's trademark. Another option is to require a distributor to maintain a link to the supplier's website, with a disclaimer that the supplier is not in any way responsible for representations made by the distributor's website.

By permitting its distributors to use the inherently borderless internet, a supplier may thereby enable distributors who are limited to specific geographic territories to sell into another's territory. In order to inhibit such activity a supplier may require internet distributors to collect consumer's zip codes before proceeding and to refuse or redirect any consumer who is not located within the distributor's territory.

The internet also creates virtually endless possibilities for the collection and analysis of consumer data. Information obtained from customers through internet transactions can be used to market through highly targeted advertising campaigns. If a supplier wishes to have access to and control over customers' data collected by a distributor through its website, there should be a provision in the agreement explicitly stating that all data collected regarding customers of the product shall be deemed to be the supplier's property and shall not be used by the distributor or sold, licensed, disclosed or transferred to any party other than the supplier without the supplier's written permission. In contrast, distributors generally will want to safeguard such information from disclosure to, or at least use by, the supplier, as free use of detailed customer data will greatly facilitate the transition to a replacement distributor.

60 *Foodmaker, Inc. v. Quershi*, BUS. FRAN. GUIDE (CCH) ¶11,780 (Cal. Sup. Ct. 1999).

Moreover, a supplier should specify guidelines for the collection of consumer data. An internet distributor should be explicitly required to comply with all applicable privacy and consumer protection laws, to post and comply with its own privacy policy and to disclose to consumers that their information will be shared with the supplier and obtain their consent when necessary.[61] Note that the European Union, Canada and other countries strictly regulate the collection and use of consumer data in their territory or from their citizens.

IX. *Contents – Pricing, Payment Terms and Execution*

Pricing methods should be specified, whether as determined from time to time by the supplier, or restricted in some fashion. Restrictions can include minimum notice of changes, limitations on frequency of changes, and limitations on the amount of increases, whether pegged to cost increases, consumer price indices, industry market prices, specified percentages, or otherwise. Whether prices are to be F.O.B. supplier's facility, ex works, C&F, C.I.F. or otherwise, should be specified, or the matter expressly left to supplier's specification by invoice. Note that these terms may have different meanings under the Uniform Commercial Code applicable in most states and the International Chamber of Commerce's Incoterms, often used in international transactions. The distribution contract should make clear what is intended.

Restrictions on resale pricing may be permissible under the antitrust laws after the Supreme Court's landmark *Leegin* decision62, as they are now judged by the rule of reason, but need to be carefully vetted for potential anticompetitive effects.

Payment terms should be addressed as well, although suppliers will want the freedom to reduce terms for valid credit reasons. If the supplier desires payment by electronic funds transfer or has an electronic data interchange system for ordering and payment, the distribution agreement should provide for the distributor's participation and for the formation of a contract upon receipt of an order from the distributor's computer and acceptance by the supplier's computer, with a procedure for resolving discrepancies between the supplier's and the distributor's computer records.

It is important that the parties adopt a commercially reasonable authentication procedure for such electronic transactions. In international transactions, the United Nations Commission on International Trade Law (UNCITRAL), Model Law on E-Signatures, which was adopted on July 5, 2001, states that "[w]here the law requires a signature of a person, that requirement is met in relation to a data message if an electronic signature is used that is as reliable as was appropriate."[63] The federal Electronic Signatures in Global and National Commerce Act[64] ("E-SIGN") imposes no specific requirements on electronic documents and signatures, which under E-SIGN are given equal validity to paper contracts and signatures. Rather, it leaves it to the market to determine what types of electronic signatures will succeed and be accepted. Nevertheless, prudence dictates that a form of signature be used which can be authenticated and ensures the integrity of the document to which it is affixed.

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61 For further discussion of such privacy issues, as well as other internet distribution issues, *see* A.R. Jaglom, *Internet Distribution and Other Computer Related Issues: Current Developments in Liability On-Line, Business Methods Patents and Software Distribution, Licensing and Copyright Protection Questions*, elsewhere in these materials.

62 *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. ____, 2007 WL1835892 (2007).

63 *UNCITRAL Model Law on Electronic Signatures*, U.N. Comm'n on Int'l Trade Law, 34th Sess., Art. 6.1 (2001).

64 Pub. L. 106-229 (2000).

X. *Contents — Sales Responsibilities*

The distributor can be required to maintain a specified level of inventory, including replacement parts; to call on all or certain customers at a specified frequency; to maintain a sales force of a specified size and quality; to promote sales or advertise; and so on. (The supplier generally should retain a right of approval over all advertising and promotional materials.) The responsibility of distributors to provide specified post-sale warranty or non-warranty service and to maintain service staff and facilities should be addressed, as well as the allocation of the financial burden of warranty service between supplier and distributor.

Distributors should especially beware of "best efforts" clauses, which may be construed to require all possible efforts, even if they result in lower profits, if not actual losses.[65] Under certain circumstances, a "best efforts" clause may be construed to prohibit the distribution of competing products.[66] "Full time efforts" poses similar issues, although one court has held that sales of small quantities of complementary brands were not precluded.[67] "Reasonable efforts" are therefore usually preferable for a distributor. "Diligent efforts" may be a suitable compromise. Although suits by suppliers against distributors for failure to perform are less frequent than distributor suits against suppliers for wrongful termination, there are occasions in which substantial damages have been awarded for distributors' failure to market and promote adequately.[68] Note that in the case of exclusive dealing arrangements, U.C.C. section 2-306(2) imposes a best efforts obligation on the seller to supply and on the buyer to promote sales of the goods. Thus, a provision in the agreement disclaiming such an obligation should be considered.

XI. *Contents — Reporting Responsibilities*

The supplier may require certain sales reports at specified intervals. The level of detail of such reports may be a matter for negotiation. As noted above, distributors may view detailed customer data as proprietary; certainly a supplier has an easier transition to a replacement distributor if it has free use of detailed customer sales data.

Written marketing and sales plans can be required to be submitted to the supplier for approval before implementation. If responsibility for developing these plans rests with the distributor, some state franchise laws may not apply; if the supplier prescribes a marketing plan, these laws may be applicable.[69]

XII. *Contents — Trade Secrets*

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65 *See Bloor v. Falstaff Brewing Corp.*, 601 F.2d 609 (2d Cir. 1979) (agreement to use best efforts to maintain high volume did not require steps involving substantial losses, but did require action to maintain volume even if result was lower profits). *But cf. Faith v. Faith*, 709 So.2d 600 (Ct. App. Fla 1998) (obligation of best efforts to complete warehouse purchase did not require purchase when expected rate of return was substantially below customary level); *Kroboth v. Brent*, 215 A.D.2d 813, 625 N.Y.S.2d 748 (3d Dep't 1995) (best efforts obligation requires pursuit of all reasonable methods to achieve objective).

66 *See Joyce Beverages of New York, Inc. v. Royal Crown Cola Co.*, 555 F. Supp. 271 (S.D.N.Y. 1983); *see also Van Velkenburgh v. Hayden Publishing Co*, 30 N.Y.2d 34, 281 N.E.2d 142, 330 N.Y.S.2d 329, 173 U.S.P.Q. 740 (N.Y. 1972) (promotion of competing books developed to compete with publisher's books violated best efforts obligation).

67 *Southland Distributors Marketing Co. v. S&P Co.*, 296 F. 3d 1050 (11th Cir. 2003).

68 *See, e.g., Maaco Enterprises, Inc. v. Bremner*, 1998 WL 669936, BUS. FRAN. GUIDE (CCH) ¶ 11,498 (E.D. Pa. 1998) (franchisor entitled to lost future royalties for 13 year balance of franchise agreement terminated for franchisee's repeated failure to pay royalties); *Burger King Corp. v. Barnes*, 1 F. Supp.2d 1367 (S.D. Fla. 1998) (franchisor entitled to nearly $250,000 in lost profits from franchisee who abandoned franchise with over 17 years remaining); *Cassini Awarded $16 Million*, N.Y. TIMES, June 1, 1988, at D2, Col. 4 (reporting jury award in suit for failure to promote properly).

69 *See, e.g.*, Cal. Bus. & Prof. Code § 20001; N.Y.G.B.L. § 681(3).

If the supplier will be disclosing trade secrets to the distributor or if the distributor will learn or develop confidential information, it is important to provide that the distributor and its employees will maintain the information in confidence and use it only as permitted, both *during* and *after* the term of the agreement. Failure to take steps to protect the confidentiality of a trade secret may result in the loss of the ability to protect it.[70] This may be particularly important where technology is concerned. It may also apply to such proprietary information as customer lists and requirements, formulas or product specifications, pricing information, and business or new product plans. A supplier may want a provision stating that the distributor acquires no rights to such information by virtue of its being a distributor. Distributors, as noted above, may want to limit supplier access to, or use of, detailed customer information. It is important that confidential information be carefully described and include information which each party learns by reason of its relationship with the other.

XIII. *Contents — Restrictions on Competition*

If the supplier will be providing valuable competitive information to the distributor, including information regarding customers and their needs, a restriction on competition by the distributor with the supplier during and after the agreement may also be advisable, particularly if trade secrets are to be disclosed to the distributor. Otherwise, a knowledgeable distributor could do substantial damage by selling competing products to the supplier's customers. A review of state law is important here, as the states differ widely in their treatment of such clauses, with some states holding such restrictions to be entirely unenforceable.[71]

A. *Ancillary Nature.* To be enforceable, such clauses generally must be "ancillary" to the agreement and in furtherance of the agreement's lawful purposes.[72]

B. *Reasonableness.* Courts have applied a reasonableness standard in assessing whether a noncompete clause is enforceable, taking into consideration (i) the length of time,[73] geographic area, and activities restricted; (ii) the hardship to the distributor; and (iii) the public interest.[74] As an alternative to

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70 *See, e.g.*, 12 BUSINESS ORGANIZATIONS, 1 R. MILGRIM ON TRADE SECRETS § 2.01 at 2-12 (1987) (quoting RESTATEMENT OF TORTS § 757, comment to (1939)) ("measures [must be] taken . . . to guard the secrecy of the information"); *Financial Programs, Inc. v. Falcon Financial Services, Inc.*, 371 F. Supp. 770, 777 (D.Ore. 1974); *National Stock Products, Inc. v. Polymer Industries, Inc.*, 79 N.Y.S.2d 357, 360 (1st Dep't 1948).

71 *See, e.g., Cottman Transmission Sys., Inc. v. Melody*, 851 F. Supp. 660 (E.D.Pa. 1994) (Calif. law); *Scott v. Snelling and Snelling, Inc.*, 732 F. Supp. 1034 (N.D. Cal. 1990).

72 *See United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 282 (6th Cir. 1898), *modified and aff'd*, 175 U.S. 211 (1899) ("[N]o conventional restraint of trade can be enforced unless the covenant embodying it is merely ancillary to the main purpose of a lawful contract, and necessary to protect the covenantee in the enjoyment of the legitimate fruits of the contract, or to protect him from the dangers of an unjust use of those fruits by the other party").

73 A case in New York held that a one year non-compete clause was unreasonable in duration as applied to an editor for a technology information publication, because of the speed at which the Internet industry moves. In that context, the court held, one year is "several generations, if not an eternity." *Earth Web, Inc. v. Schlack*, 71 F. Supp. 2d 299, 316 (S.D.N.Y. 1999).

74 *See, e.g., Interstate Automatic Transmission Co. v. W.H. McAlpine Co.*, 1981 WL 2193, 1982-1 TRADE CAS. (CCH) ¶ 64,538 (N.D. Ohio 1981); *see generally* RESTATEMENT OF CONTRACTS § 514 (1932). Post-term noncompete clauses have been upheld if they are short in duration and in a limited geographic area. *See, e.g., Wilkinson v. Manpower, Inc.*, 531 F.2d 712 (5th Cir. 1976) (in a six-county area; for two years); *Meineke Discount Muffler Shops, Inc. v. Bleier*, Civ. Act. No. H-80-2495 (S.D. Tex. 1981) (25-mile radius of former shop; for one year); *Shakie's, Inc. v. White*, No. 77-106, slip op. (E.D. Mo. 1977) (within 30 miles of the franchised location; for one year); *Snelling & Snelling, Inc. v. Dupay Enters., Inc.*, 125 Ariz. 362, 609 P.2d 1063 (1980) (within 35 miles of franchised location; for three years).

the typical geographic restriction, the supplier may want to consider imposing a restriction on selling to specified customers or to customers purchasing the supplier's products during a specified period.

C. *Franchise Agreements.* In the franchise relationship certain interests not present in the usual buyer-seller relationship may exist and these interests may be protectible through noncompete clauses, for example, integrity of the franchise, marketability of the franchise, and protection of shared confidential business information. For these reasons, competition might be restricted not only near the franchisee's location but also near the location of any franchisee.[75] Some states, however, prohibit or limit such post-term noncompete clauses by statute.[76] And other states have invalidated overbroad restrictions in franchise agreements on public policy grounds.[77]

D. *Bankruptcy*. It may be prudent to recite that the noncompete clause is a separate agreement from the overall contract, supported by separate consideration, such as the supplier providing training and access to valuable confidential information, and fully vests upon the provision of that consideration. Otherwise a rejection of the entire contract by a bankrupt distributor under section 365 of the Bankruptcy Code might be held to render the noncompete clause unenforceable.[78]

E. *Survival of Clause*. Similarly, the agreement should provide that the non-competition clause will survive the termination, expiration or assignment of the agreement, so that its effect is not vitiated.[79]

F. *Irreparable Injury*. The agreement should also provide that breach of the noncompete agreement will cause the supplier irreparable injury for which money damages are neither adequate nor fully ascertainable, and that injunctive relief is therefore to be available as a remedy for any such breach.

XIV. *Contents — Restrictions on Transfer*

The supplier may wish to restrict assignment of the agreement. The distributor may wish to be able to sell his business and assure the purchaser of a right to keep the distributorship. If assignability of the distribution agreement is to be restricted, the transfer provision should cover stock sales and asset sales, mergers and consolidations, as well as changes in management or control. The distributor might require

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75 *See, e.g., Casey's General Stores, Inc. v. Campbell Oil Co., Inc.*, 441 N.W.2d 758 (Iowa Sup. Ct. 1989). *See also Physicians Weight Loss Centers of America v. Creighton*, 1992 WL 176992, BUS. FRANCHISE GUIDE (CCH) ¶ 10,248 (N.D. Ohio 1992) (noncompete clause unenforceable in the absence of actual competition by franchisor within the specified geographic area).

76 *See, e.g.*, Ind. Code Ann. § 23-3-2.7-1(9) (Burns 1982); Mich. Stat. Ann. § 28.61 (Callaghan 1981). *But see* Fla. Stat. Ann. § 2.33(2)(b) (West 1981) (expressly allowing noncompete covenants in franchise relationship).

77 *Gandolfo's Deli Boys, LLC v. Holman*, 490 F.Supp.2d 1353 (N.D. Ga. 2007) (restrictive covenant unenforceable under Georgia law where prohibition barred interest "in any capacity" in broad category of restaurants, within ten miles of any franchised location, so restricted territory could not be determined until contract terminated).

78 *See In re JRT, Inc.*, 121 B.R. 314, 323 (Bankr. W.D. Mich. 1990); *Silk Plants, Etc. Franchise Systems, Inc. v. Register*, 95 B.R. 73 (Bankr. M.D. Tenn.), *aff'd*, 100 B.R. 360 (M.D. Tenn. 1989); *but see In re Hirschhorn*, 156 B.R. 379 (Bankr. E.D.N.Y. 1993) (rejection of executory contract does not render covenant not to compete unenforceable); *In re Audra-John Corp.*, 140 B.R. 752 (Bankr. D. Minn. 1992) (remedy for breach of contract caused by rejection in bankruptcy is governed by state law, but franchisor did not meet state law injunction standards); *In re Don & Lin Trucking Co., Inc.*, 110 B.R. 562 (Bankr. N.D. Ala. 1990) (enforcing noncompete clause after rejection of contract on ground that rejection terminated mutual performance obligations but did not affect provisions dealing with termination).

79 *See, e.g., Business Investment Group of Alabama, Inc. v. Cleveland*, 571 So. 2d 1021 (Ala. Sup. Ct. 1990) (franchisee not bound by non-competition clause after it purchased assets of corporation to which it had previously lawfully assigned franchise); *Sonny's Pizza, Inc. v. Bradley*, 612 So. 2d 844 (La. App. 1992) (non-competition clause construed to apply only upon "termination" of license, *i.e.*, its premature end, and not upon expiration due to passage of time).

that the supplier's consent to a change not be unreasonably withheld. Standards to be met by transferees might be established. Some state franchise laws may limit restrictions on assignment or transfer, and should be reviewed.[80]

XV. ***Contents — Use of Trademarks***

The agreement should specify whether and to what extent the distributor has the right to use the supplier's trademarks. For example, the distributor may be permitted to use the trademark in its business name or it may be limited solely to identifying the goods or services it sells. The scope of any license should be spelled out clearly. Any limitations on trademark use in websites or otherwise online, including use of trademarks in metatags (visible to search engines but not to users) or their incorporation in domain names, also should be detailed.

Note that a license limited to use of the trademark within a specific territory, or limited to use in the sale of goods as permitted in the agreement, may convert extraterritorial sales or transshipment from a simple breach of contract to a trademark infringement claim.

If a trademark license is granted, the licensor should provide for procedures to maintain quality control or its trademark rights may be jeopardized.[81] It is typical to require all advertising or other materials incorporating the supplier's marks to be approved in advance by the supplier. Note also that the extent to which the distributor's business is associated with the supplier's trademarks may affect the applicability of state franchise laws.[82]

It is also important to spell out the distributor's obligations regarding the protection of the trademarks. Regardless of how responsibility for enforcement is divided, the contract should specify how any recovery for damages from infringement is to be divided between supplier and distributor. The same is true for any other intellectual property that may be licensed.[83]

XVI. ***Contents — Supplier Obligations***

The distributor should spell out any services or other obligations needed from the supplier. For example, a minimum level of supply may be required. Support services, technical assistance (both to the distributor and its customers), training of the distributor's personnel and minimum advertising or promotional levels to be provided by the supplier all may be specified. (To the extent that the distributor will be responsible for any advertising, the supplier should retain a right of approval.) Also, the supplier may be required to provide brochures or other promotional materials.

XVII. ***Contents — Limitation of Warranties; Indemnification; Insurance.***

A supplier, if it is not the manufacturer, will not want to give a warranty or assume any liability greater than that of the manufacturer. A manufacturer will seek, consistent with applicable law and business considerations, to limit its warranty and liability. Such a limitation was held effective in a

80 *See, e.g.*, Mich. Comp. Laws § 445.1527(g).

81 *See, e.g., Kentucky Fried Chicken v. Diversified Packaging*, 549 F.2d 368, 387, (5th Cir. 1977); *Sheila's Shine Products, Inc. v. Sheila Shine, Inc.*, 486 F.2d 114, 123-24 (5th Cir. 1973).

82 *See, e.g.*, Cal. Bus. & Prof. Code § 20001; Mich. Comp. Laws § 445.1502(b).

83 *See, e.g., Original Appalachian Artworks v. S. Diamond Associates, Inc.*, 911 F.2d 1548 (11th Cir. 1990) (holding licensee of copyright, if injured, is entitled to share in settlement proceeds from third party infringer).

Massachusetts case holding Mack Trucks' disclaimer of the implied warranty of merchantability enforceable as against a subsequent purchaser without notice.[84]

The distributor, on the other hand, will want protection against third party claims, in the form of an indemnification, insurance or both. Third party claims can include claims under a product warranty, product liability, and infringement of patents, trademarks or copyright, or claims by a prior distributor of interference. To the extent that the distributor also fabricates or assembles the product, incorporates it into another product or services it, it can be required to take some responsibility for third party claims arising out of those activities.

In examining this issue it is necessary to consider the nature of the product and the use (industrial vs. consumer), as well as the service or assistance which is given to a customer by the manufacturer or distributor. The scope of indemnification should be spelled out, as well as whether the indemnification includes attorneys' fees and either the right or the duty to assume the defense of any claims, and whether it includes only proven claims or all allegations of covered claims. If insurance will be required of either party, the amount should be specified and the other party should be named as an additional insured.

XVIII. *Contents — Duration*

The contract may be for a specified term, or indefinite until terminated. Note that some state franchise laws place stricter limits on termination during the contract term than on nonrenewal after expiration.[85] If a specific duration is provided for, consider whether renewal is to be automatic if no notice is given, whether it requires a notice of renewal or the execution of a new agreement. The decision will depend in part on the existence of a systematic procedure for the client to assure that notice will be given. A distributor may want the guaranteed right to renew if certain performance standards are met.

In many states, a contract with no specified duration is terminable at will, on reasonable notice, but if the contract provides for termination upon the occurrence of specified events, it is not of indefinite duration and may not be terminated except when such events occur.[86] Other states disfavor perpetual agreements, at least in the absence of a specifically stated intent. Thus, a contract with defined terms, but subject to automatic renewal, was held to be for fixed terms renewable only if both parties consented, in the absence of an unequivocal statement of an intent to create a perpetual agreement.[87]

In one case under Puerto Rico's restrictive Dealer Contract Act, a distributor's failure to give written notice of renewal as required by contract was held good cause for non-renewal.[88] The court stressed that the non-renewal there was occasioned by the *distributor's* non-renewal, not the supplier's. This suggests the inclusion of such a renewal requirement, although if the requirement is ignored for years and then suddenly enforced, the courts are likely to be unsympathetic to the supplier.

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84 *Theos & Sons, Inc. v. Mack Trucks, Inc.*, 729 N.E.2d 1113 (Mass., 2000).

85 *See* Cal. Bus. & Prof. Code §§ 20021, 20025 (West 1986 Supp.); Minn. Stat. Ann. § 80C.14(b), (c) (West 1986).

86 *See, e.g., Zee Medical Distributor Association, Inc. v. Zee Medical, Inc.*, 94 Cal. Rptr. 2d 829, 2000 Cal. App. LEXIS 307 (2000).

87 *Armstrong Business Services v. H&R Block*, 96 S.W. 3d 867, BUS. FRAN. GUIDE (CCH) ¶12,485 (Mo. App. W.D. 2002)

88 *Nike Int'l Ltd. v. Athletic Sales, Inc.*, 689 F. Supp. 1235 (D.P.R. 1988).

XIX. *Contents — Termination*

A. *Grounds.* The parties will generally wish to specify the basis on which the agreement may be terminated. State laws may restrict these grounds.[89] Among the issues to be considered are the following:

1. *Without Cause.* May either party terminate without cause? If so, this should be explicitly stated.[90]

2. *Performance Standards*. The inclusion of mandatory performance standards appropriate to the product, industry and territory may be desirable. They can be stated in dollar terms, unit terms, as a percentage of average regional or national performance, in terms of market share, or on some other basis. Sales figures are generally better for the supplier and worse for the distributor than purchase requirements; the latter, if they force a dealer to buy more product than it can sell, might be deemed a franchise fee. Moreover, if achievement of standards results in automatic renewal, standards based on purchases rather than sales allows the dealer to obtain a renewal by buying into inventory without genuinely building a larger market for the product. If the intent is to allow the supplier to terminate or not renew if minimum standards are not met, this should be explicitly set forth. Distributors will wish to make clear that termination is the only remedy for failing to meet the standard and that there is no liability for damages as a result of any shortfall. Similarly, the supplier may wish to provide for a right to terminate if the parties cannot agree on new minimum standards for a renewal term, while distributors should resist such a provision.

Courts may examine the reasonableness of performance standards.[91] The supplier, in setting the standards, thus should be prepared to exercise the right to terminate consistently among those who do not meet the standard.[92] An alternative is to provide for the right to add additional distributors (i.e., to terminate the distributor's exclusivity) if performance levels are not reached.[93]

3. *Other Breaches.* Other breaches of contract may occur. The parties should specify whether any breach justifies termination and, if not, which do. In addition, the contract should specify when, if ever, the party in breach is to be afforded an opportunity to cure, and in what period. It may be prudent to stipulate that certain breaches are agreed to be noncurable.

4. *Changes in Ownership and Control.* The supplier may provide that a change in ownership, management, or control of the distributor justifies termination. Some conditions might be included. For example, termination might be permitted upon a transfer of some percentage of the ownership of one or the other party or upon the replacement of specified officers.

5. *Financial Problems.* The supplier may wish to terminate if the distributor is financially unstable. The triggering event can include liens (other than routine financing liens), insolvency, the inability to pay debts as they become due, or bankruptcy. Note that if the agreement has not been

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89 *See, e.g.*, Cal. Bus. & Prof. Code § 20020 *et seq.*

90 But see notes 4 and 5 above and accompanying text.

91 *See, e.g., R&R Assocs. of Connecticut, Inc. v. Deltona Corp.*, BUS. FRAN. GUIDE (CCH) ¶ 7526 (D. Conn. 1980); *see generally* E. Spalty and T. Dicus, *Risky Business: Franchise Terminations for Failure to Meet Performance Quotas*, FRANCH. L.J., Spring 1987, at 1.

92 *See, e.g., Marquis v. Chrysler Corp.*, 577 F.2d 624, 632-33 (9th Cir. 1978) (the selective enforcement of an unrealistic quota may violate the federal Automobile Dealer's Day in Court Act).

93 This option may not be available in some industries in some states where the practice of "dualing" may be prohibited. *See, e.g.*, Ga. Regs. §560-2-5.02 (Alcohol Beverage Control regulations).

terminated before a bankruptcy filing, section 365 of the Bankruptcy Code will allow the distributor the option to reject the contract or to affirm it and so prevent termination unless independent grounds for termination exist apart from the bankruptcy.[94] This suggests providing for a right to terminate for insolvency prior to bankruptcy, although to terminate for insolvency, the supplier may be required to have had knowledge of the insolvency at the time of termination.[95] Any such provision should provide that insolvency includes both balance sheet insolvency (value of liabilities exceeding value of assets) and the common law test of inability to pay debts as they come due.[96] Note that defaults by the distributor after bankruptcy may provide independent grounds for termination.[97]

In the context of intellectual property licenses, special rules apply. If a bankrupt licensor rejects a license agreement for patent, copyright or trade secret rights, the licensee may elect either to retain its rights to the intellectual property (including any exclusivity) for the duration of the agreement, including any period for which the licensee has the right to extend the agreement, or to treat the agreement as terminated by the rejection.[98] If the licensee elects to continue the license, it is not entitled to any maintenance or support services that might be called for under the license agreement, nor is it entitled to receive updates of the intellectual property at issue. In short, the licensee gains only the right to continue to use the intellectual property "as is."

6. *Other Circumstances.* The supplier may desire the right to terminate in a variety of other circumstances. For example, if the distributor acts so as to injure the business reputation of the supplier or the products, or if there is a violation of law in connection with the business, termination may be warranted. The supplier may also want the right to terminate if it decides to withdraw from the product or geographic market or to convert to a direct or other distribution channel. State laws may restrict termination in these circumstances.[99]

B. *Notice.* The drafter should consider how much notice is required and whether the distributor may cure. The reasonableness of this provision will depend on the circumstances. Note that state franchise laws may require minimum notice and an opportunity to cure. It may be prudent to provide for what, if anything, will be considered a cure of such deficiencies as a failure to meet performance standards or the making of prohibited out-of-territory sales.

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94 11 U.S.C § 365. A termination notice given before the bankruptcy filing, but effective afterward, generally will be given effect, so long as only the passage of time is necessary for the termination to become effective, *i.e.*, there is no right to cure remaining after the time of filing. *See Atlantic Richfield Co. v. Herbert*, 806 F.2d 889 (9th Cir. 1986); *Moody v. Amoco Oil Co.*, 734 F.2d 1200, 1212-13 (7th Cir. 1984). *But cf. In re Krystal Cadillac Oldsmobile GMC Truck, Inc.*, 142 F. 3d 631, BUS. FRAN. GUIDE (CCH) ¶ 11,389 (3d Cir. 1998) (where termination was not effective until rejection of appeal by Pennsylvania Vehicle Board, and appeal was not rejected until after bankruptcy filing, franchise agreement was part of bankruptcy estate and subject to automatic stay).

95 *See Bruno Wine & Spirits, Inc. v. Guimarra Vineyards*, 573 F. Supp. 337 (E.D.Wis. 1983) (applying Wisconsin Fair Dealership Law).

96 *See Comp III, Inc. v. Computerland Corp.*, 136 B.R. 636 (Bankr. S.D.N.Y. 1992) (summary judgment for franchisor denied where contract allowed termination upon insolvency but did not specify definition of insolvency to be used, and franchisee met balance sheet test but may not have met common law test for insolvency).

97 *See Dunkin Donuts of Puerto Rico, Inc. v. Santa Rosa Enterprises, Inc.*, BUS. FRAN. GUIDE (CCH) ¶ 8914 (Bankr. D.P.R. 1987).

98 11 U.S.C. § 365(n).

99 *See, e.g., Kealey Pharmacy & Home Care Service, Inc. v. Walgreen Co.*, 539 F. Supp. 1357 (W.D. Wis. 1982), *aff'd*, 761 F.2d 345 (7th Cir. 1985); *Westfield Centre Service, Inc. v. Cities Service Oil Co.*, 86 N.J. 453, 432 A.2d 48 (1981).

C. *Effect on Non-Compete.* The effect of termination on any restrictions on competition by the distributor should be considered. Different grounds for termination might have different effects. For example, termination by the supplier without cause might free the distributor to compete.

D. *Inventory Repurchase.* Consideration should be given to whether the supplier should have either the right or the obligation to repurchase unsold inventory on termination. Generally the supplier will want the right to repurchase, so as to prevent the terminated distributor from dumping the product on the market at distress prices. Moreover, if the supplier has such a right, but not the obligation to buy back inventory, the agreement to do so can serve as consideration for a release from the distributor; if the contract required the repurchase, the supplier's performance of that requirement would not constitute consideration. Distributors will prefer to have the option to sell off inventory, or at least to have the supplier's repurchase be mandatory, not optional, so as to avoid allowing a supplier to leave the distributor with slow-moving products. Note that some state laws require such an inventory repurchase; obviously, in such states the repurchase would not be consideration for a release.

E. Finally, the distributor may wish to be compensated upon termination for the value of its lost distribution rights. Even in the case of a termination for cause, it may seek compensation, less any damages resulting from the cause. Suppliers will generally resist such compensation, although they should consider the benefit of an increased incentive for the distributor to invest in the brand if it knows it will be fairly compensated for the value of its distribution rights on termination, especially given that the incoming distributor should ordinarily be willing to pay fair value for the rights it is obtaining. The practice varies from industry to industry and from state to state. Beer distribution rights are regularly paid for on termination, and indeed such compensation is required by law in some states.[100] In contrast, such compensation is atypical for wine and spirits, a distinction perhaps lacking in any internal logic.

Assuming compensation is to be provided, the parties may wish to define the basis upon which it is determined. Fair market value, whether based on appraisal or economic analysis, or formulae based upon multiples of sales, gross profits, net profits or other factors, are all possibilities. If the distributor does not pay for the distribution rights initially, then compensation on termination might be based only on increases in value, sales or profits over the life of the distributorship.

XX. *Contents — Arbitration*

Counsel should consider whether a provision for arbitration is desirable. If included, such a provision will generally be enforced, even in the face of state law to the contrary.[101] Although domestic

100 *e.g.*, N.Y. Alc. Bev. Law §55-c.

101 *See Doctor's Associates v. Casarotta*, 517 U.S. 681, 116 S. Ct. 1652 (1996); *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 513 U.S. 1040, 115 S. Ct. 1212 (1995); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987); *Southland v. Keating*, 465 U.S. 1 (1984); *KKW Enterprises, Inc. v. Gloria Jean's Gourmet Coffees Franchising Corp.*, 84 F.3d 42 (1st Cir. July 19, 1999) (upholding clause calling for arbitration outside Rhode Island despite franchise law provision that contract requiring venue outside Rhode Island is unenforceable); *Doctor's Associates, Inc. v. Hamilton*, 150 F.3d 157 (2d Cir. 1998); *S+L+H S.p.A v. Miller - St. Nazianz, Inc.*, 988 F.2d 1518 (7th Cir. 1993); *Saturn Distribution Corp. v. Williams*, 905 F.2d 719 (4th Cir. 1990); *Mitsubishi Motors v. Soler Chrysler-Plymouth, Inc.*, 723 F.2d 155, 158 (1st Cir. 1983); *aff'd*, 473 U.S. 614 (1985); *Medika Int'l, Inc. v. Scanlan Int'l, Inc.*, 830 F. Supp. 81 (D.P.R. 1993); *Salon Brokers, Inc. v. Sebastian Int'l, Inc.*, BUS. FRAN. GUIDE (CCH) ¶ 9586 (Mich. Ct. App. 1990); *but see Hambell v. Alphagraphics Franchising, Inc.*, 779 F. Supp. 910 (E.D. Mich. 1991); *Sterling Truck Corp. v. Sacramento Valley Ford Truck Sales*, 751 N.E.2d 517 (Ohio Ct. App. 2001), *appeal denied*, 748 N.E.2d 547 (Ohio 2001) (arbitration clause superseded by state law granting California New Motor Vehicle Board authority to determine existence of good cause for termination, because of severability clause which provided that "any provision of this Agreement which in any way contravenes any law of any relevant jurisdiction shall be deemed not to be a part of this Agreement in such jurisdiction"); *Barter Exchange, Inc. of Chicago v. Barter Exchange, Inc.*, 238 Ill. App. 3d 187, 179 Ill. Dec. 354, 606 N.E.2d 186 (Ill. App. Ct. 1992, *appeal denied*, 149 Ill. 2d 647, 183 Ill. Dec. 858, 612 N.E.2d 510 (Ill. 1993) (franchisor's failure

antitrust claims were at one time considered not to be arbitrable, courts are now enforcing arbitration agreements even in this area.[102] Note, however, that where state law requires a disclosure that a choice of law or choice of forum provision may not be enforceable in that state, a question arises as to whether the parties really agreed to the contractual choice. The Ninth Circuit has held in such circumstances that a contractual choice of forum for arbitration was unenforceable in light of such a mandated disclaimer, finding that the franchisee had no reasonable expectation that it had agreed to an out-of-state forum.[103]

Suppliers should consider limiting the relief the arbitrators may award to actual compensatory damages in the amount of ascertainable injury, expressly precluding punitive damages, injunctive relief or specific performance. The Supreme Court has held that the central purpose of the Federal Arbitration Act is to ensure "that private agreements to arbitrate are enforced according to their terms," so that the parties' decision as to whether arbitrators may award punitive damages will supersede contrary state law as to the scope of arbitrators' authority.[104] In addition, suppliers should consider including language denying preclusive, or collateral estoppel, effect to issues resolved by arbitration with one distributor in later proceedings with other distributors.

Care should be taken in drafting arbitration clauses not to overreach. For example, the Ninth Circuit

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to register under state franchise law made franchise agreement void, so arbitration clause was unenforceable); *contra, Cusamano v. Norell Health Care, Inc.*, 239 Ill. App.3d 648, 180 Ill. Dec. 352, 607 N.E.2d 246 (Ill. App. 1993) (rejecting *Barter Exchange, Inc. of Chicago, supra*, and enforcing arbitration, but rejecting choice of law clause).

102 *See Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985) (holding antitrust claims arbitrable in international context without reaching question as to domestic claims); *Nghiem v. NEC Electronic, Inc.*, 25 F.3d 1437 (9th Cir.), *cert. denied*, 513 U.S. 1044, 115 S. Ct. 638 (1994); *Kotam Electronics, Inc. v. JBL Consumer Products, Inc.*, 93 F.3d 724 (11th Cir. 1996) (*en banc*), *cert. denied*, 519 U.S. 1110, 117 S.Ct. 946 (1997) (domestic antitrust claims arbitrable); *Kowalski v. Chicago Tribune Co.*, 854 F.2d 168 (7th Cir. 1988), *cf. Sanjuan v. Amer. Bd. of Psychiatry & Neurology*, 40 F.3d 247, 250 (7th Cir. 1994) (arbitrability of antitrust disputes depends on neutrality of arbitrators; agreement to arbitrate before board of directors of producers' association is unenforceable). The leading case holding domestic antitrust claims nonarbitrable was *American Safety Equip. Corp. v. J.P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968). Although the Second Circuit has yet to abandon its *American Safety* holding explicitly, the courts have determined that after *Mitsubishi*, *American Safety* no longer remains good law. *See In re Currency Conversion Fee Antitrust Litigation*, 265 F. Supp. 2d 385, 409 (S.D.N.Y. 2003) (*American Safety* has been "effectively overruled"); *N.Y. Cross Harbor Railroad Terminal Corp. v. Consolidated Rail Corp.*, 72 F. Supp. 2d 70, 79-80 (E.D.N.Y. 1998) (lower courts have subjected domestic antitrust claims to arbitration); *Hough v. Merrill Lynch*, 757 F. Supp. 283, 286 (S.D. N.Y.) *aff'd without o.p.*, 946 F.2d 883 (2d Cir. 1991) (holding that reasoning of *Mitsubishi* applies equally to domestic claims, affirmed by Second Circuit); *Gemco Latinoamerica, Inc. v. Seiko Time Corp.*, 671 F. Supp. 972, 978-80 (S.D.N.Y. 1987) (Second Circuit would abandon *American Safety* rule if confronted with issue). And in 2004, the Second Circuit, without citing *American Safety*, nonetheless held ocean shipping antitrust claims to be arbitrable, without any reference to their international character, and cited In re *Currency Conversion Fee Antitrust Litigation* with approval. *JLM Industries, Inc. v. Stolt Nielson SA*, 387 F. 3d 163 (2d Cir. 2004).

103 *Laxmi Investments, LLC v. Golf USA*, 193 F.2d 1095, (9th Cir. 1999); *see also Great Earth Companies, Inc. v. Simons*, 2000 WL 640829, BUS. FRAN. GUIDE (CCH) ¶ 11,823 (S.D.N.Y. 2000) (arbitration provision upheld but New York choice of forum unenforceable because franchisor had fraudulently misrepresented that Michigan Franchise Investment Law prohibited enforcement of out of state forum selection provision; franchisee reasonably relied on misrepresentation). *But see Bradley v. Harris Research, Inc.*, 2001 U.S. App. LEXIS 27284, BUS. FRAN. GUIDE (CCH) ¶ 12,221 (9th Cir. 2001) (Federal Arbitration Act preempts California Franchise Investment Act provision making non-California forum clause unenforceable; distinguishing *Laxmi*, because plaintiff failed to show UFOC language suggesting clause might be unenforceable); *Gingiss Int'l, Inc. v. L&H Tuxes, Inc.*, BUS. FRAN. GUIDE (CCH) ¶ 12,372 (N.D. Ill. 2002) at n.7 (criticizing *Laxmi* as disregarding preemptive effect of Federal Arbitration Act).

104 *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 115 S. Ct. 1212 (1995); Treble damages have been distinguished from punitive damages, s*ee Investment Partners, L.P. v. Glamour Shots Licensing, Inc.*, BUS. FRAN. GUIDE (CCH) ¶ 12,371 (5th Cir. 2002) (permitting award of treble damages by arbitrator despite arbitration clause prohibiting punitive damages), but precluding an award of treble damages might be deemed to render the arbitration agreement void as against public policy by undermining rights guaranteed by the antitrust laws. *Id.*

held an arbitration clause unconscionable, and so unenforceable, where franchisees were required to arbitrate, but the franchisor could proceed in court.[105]

A. *Choice of Forum.* Courts generally will also enforce a provision for a particular arbitration forum.[106] Such a provision for a "home-town" forum may be of benefit to a supplier, as it may impose significant cost on a distributor forced to contest a termination. Another alternative is to provide that the arbitration is held in a neutral city, or in the home city of the party *not* commencing the proceeding, although the latter may disfavor the distributor, who is more likely to need to arbitrate.

B. *Compromise Decisions.* One disadvantage of arbitration is the tendency of arbitrators to "split the baby" and arrive at a compromise decision. This tends to disadvantage the party with the stronger legal basis for its position; thus a supplier who fears unwarranted termination disputes by dealers may wish to avoid arbitration.

C. *Lack of Discovery.* Discovery will generally be more limited in arbitration than in litigation; more often than not this will disadvantage the distributor, who may wish discovery of the supplier's reasons for termination or treatment of similarly situated distributors elsewhere.

D. *Preliminary Relief.* Preliminary injunctive relief may be less readily available in arbitration, thus precluding a distributor from forestalling a termination while the dispute is resolved.

E. *Punitive Damages.* Punitive damages are unavailable in arbitration in some states, thus lessening a supplier's exposure for wrongful termination. Many jurisdictions do, however, allow arbitrators to award punitive damages.[107] Moreover, the Eighth Circuit has held that, even where the law of a state governing a contract does not recognize an arbitral award of punitive damages, such an award is available under an arbitration clause adopting the rules of the American Arbitration Association because the Federal Arbitration Act, and not state law, governs.[108] As the judicial attitude toward arbitration becomes more and more favorable, and as still greater deference is given to the policies of the Federal Arbitration Act, it may well be that punitive damages will be universally held to be within the scope of the arbitrators' authority, at least where the agreement does not expressly limit such power. Until then, however, arbitration may, in some jurisdictions, limit a supplier's exposure.

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105 *Ticknor v. Choice Hotels Int'l*, 265 F.3d 931 (9th Cir. 2001); *See also Davis v. O'Melveny & Myers, LLC,* 485 F.3d 1066 (9th Cir. 2007) (shortened statute of limitations, overbroad confidentiality, non-mutual exemption from arbitration for some claims and limitation on administrative actions rendered employer's arbitration provision unconscionable and unenforceable); *Circuit City Stores, Inc. v. Adams*, 279 F.3d 889 (9th Cir. 2002) (arbitration clause unconscionable where employees had to arbitrate but employer did not, relief was limited, employee rights were otherwise restricted and employee had to share costs of arbitration); *Blair v. Scott Specialty Gases*, 283 F. 3d 595 (3rd Cir. 2002 (permitting plaintiff to show arbitration clause requiring her to pay half of arbitration costs imposed prohibitive burden that would prevent vindication of her statutory rights).

106 *Ledee v. Ceramiche Ragno*, 684 F.2d 184 (1st Cir. 1982) (enforcing selection of forum in spite of statute prohibiting arbitration outside Puerto Rico); but see *Great Earth Companies, Inc. v. Simons*, 2000 WL 640829, BUS. FRAN. GUIDE (CCH) ¶ 11,823 (S.D.N.Y. 2000) (arbitration provision upheld but New York choice of forum unenforceable because franchisor had fraudulently misrepresented that Michigan Franchise Investment Law prohibited enforcement of out of state forum selection provision; franchisee reasonably relied on misrepresentation).

107 *Compare, e.g., Garrity v. Lyle Stuart, Inc.*, 40 N.Y.2d 354, 353 N.E.2d 793, 386 N.Y.S.2d 831 (1976) (award of punitive damages is beyond authority of arbitrators); *Anderson v. Nichols*, 359 S.E.2d 117, 121 n.1 (W.Va. 1987) (same); *Shaw v. Kuhnel & Associates, Inc.*, 698 P.2d 880, 882 (N.M. 1985) (same); *with Raytheon Co. v. Automated Business Systems, Inc.*, 882 F.2d 6, 9-12 (1st Cir. 1989) (award of punitive damages is within authority of arbitrators); *Baker v. Sadick*, 162 Cal. App. 3d 618, 208 Cal. Rptr. 676 (4th Dist. 1984); *Grissom v. Greener & Sumner Construction, Inc.*, 676 S.W.2d 709, 711 (Tex. App. 1984) (same).

108 *Lee v. Chica*, 983 F.2d 883 (8th Cir. 1993).

F. *Lack of Appeal.* An arbitral award generally cannot be overturned other than for fraud or dishonesty. Thus there is little recourse from a poorly reasoned or otherwise incorrect decision of a bad arbitrator. In court, obviously, a right of appeal is generally available. Arbitration thus may work to the disadvantage of the party with the stronger legal position.

XXI. *Contents — Choice of Forum*

The parties can provide for all litigation arising under the agreement or its termination to be brought in a court located in a particular state and can waive their right to seek a transfer. These clauses are sometimes enforced and sometimes not.[109] The Supreme Court, in *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985), enforced a contractual choice-of-forum clause requiring a Michigan franchisee to litigate Burger King's action for breach of contract in Florida, Burger King's home state. *Burger King* merely holds that a franchisor can constitutionally enforce a forum-selection clause against its franchisees in an action commenced by the franchisor.

The supplier also should make certain that the requirements of state long arm statutes and state constitutional due process requirements are met. It is possible that courts in the distributor's home state will refuse to enforce a forum-selection clause on the ground that the public-policy interests of the distributor's state outweigh the parties' choice.[110] Note also that state franchise laws may expressly prohibit the choice of another state as a forum.[111] Federal courts, however, will apply federal law to determine whether to enforce such a clause, notwithstanding any such state view; the forum clause is not dispositive, but should be considered together with the other private and public interest factors normally weighed in a transfer motion pursuant to 28 U.S.C. § 1404(a)[112], at least where the choice is between two federal districts.

A showing of state policy sufficient to outweigh a forum clause may be difficult to make. The Supreme Court has held enforceable a fine print forum selection clause printed on the back of a cruise line's passenger ticket, requiring a Washington resident to sue in Florida for injuries sustained on a cruise off Mexico.[113] The Maryland courts have similarly held that a forum selection clause favoring the

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109 *Jones v. GNC Franchising, Inc*., 211 F.3d 495 (9th Cir. 2000), *cert. denied*, 531 U.S. 928 (2000) (Pennsylvania forum selection clause in franchise agreement between California franchisee and Pennsylvania franchisor was violative of public policy expressed in California Franchise Relations Act and therefore unenforceable). In contrast, the opposite conclusion was reached a few months earlier by a district court in *Duarte v. GNC Franchising, Inc*., BUS. FRAN. GUIDE (CCH) ¶11,815 (C.D. Cal. 2000) (upholding Pennsylvania forum selection clause in franchise agreement between Pennsylvania franchisor and California franchisee, even though invalid under California Franchise Relations Act because federal law provided for consideration of forum selection clause in determining appropriateness of transfer, and the case did not turn on matters specific to any franchise store in California).

110 *See, e.g., ECC Computer Centers of Illinois, Inc. v. Entre Computer Centers, Inc.*, 597 F. Supp. 1182 (N.D. Ill. 1984); *Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc.*, 146 N.J. 176, 680 A.2d 618 (N.J. 1996) (forum clause in contract arguably subject to Franchise Practices Act presumptively invalid; to rebut presumption, franchisor must show clause was not imposed on franchisee). *See also Davis v. Great American Cleaners, Inc.*, 1996 MASS. SUPER. LEXIS 218, BUS. FRAN. GUIDE (CCH) ¶ 10,979 (Mass. Super. Ct. 1996) (forum clause not enforced due to unequal bargaining power, burden on franchisee). *But see Moseley v. Electronic Realty Associates, L.P.*, BUS. FRAN. GUIDE (CCH) ¶ 11,430 (Ala. Ct. Civ. App. 1998) (enforcing Kansas choice of forum against Alabama franchisee).

111 *See, e.g.,* Ark. Laws of 1993, Act 310; Cal. Bus. & Prof. Code § 20040.5; Laws of Puerto Rico Ann. tit. 10, ch. 14, §278c.

112 *Stewart Organization, Inc. v. Ricoh Corp.*, 487 U.S. 22 (1988).

113 *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 111 S. Ct. 1522 (1991); *see Caribe BMW, Inc. v. Bayerische Motoren Werke Aktiengesellschaft*, 821 F. Supp. 802 (D.P.R. 1993) (enforcing choice of German forum in international agreement despite local dealer protection law), *reversed on other grounds*, 19 F.3d 745, 754 (1st Cir. 1994) (Breyer, C.J.) (remanding to determine whether forum clause covered antitrust and dealer protection law claims); *see also Dickerson v. Signs Now, Inc.*, 1994 WL

franchisor's home state was enforceable despite being incorporated into a form contract where the franchisor had superior bargaining power, reasoning that there was no fraud involved.[114] Similarly, the Sixth Circuit has enforced a choice of law and choice of forum clause contained in a contract allegedly signed in reliance on the defendant's fraud.[115] And the Western District of New York upheld a one-sided forum clause that restricted venue in actions by a franchisee, but not in actions by the franchisor.[116] The District of New Jersey has recently relied on federal law in granting a motion to transfer to the forum identified in the parties' forum selection clause.[117]

On the other hand, the District of Puerto Rico declined to transfer a dispute to California courts as called for by a contractual forum clause, as it was unchallenged that Puerto Rico was more convenient for witnesses, and there was no evidence justifying transfer other than the contract clause.[118]

In drafting forum selection clauses, counsel should make clear both that jurisdiction in the chosen forum is consented to and that venue in that forum is mandatory.[119] Arbitration clauses calling for a particular forum are highly likely to be enforced. The Seventh Circuit reversed a district court opinion and ordered arbitration in Poland pursuant to contract in a case under the Illinois Beer Industry Fair Dealing Act, holding that while the state's public policy expressed in that statute required Illinois law to apply notwithstanding the contract's choice of Polish law, that public policy could not overcome the federal policy in favor of arbitration embodied in the Federal Arbitration Act.[120]

XXII. *Contents — Choice of Law*

The parties should include a choice of law provision. Suppliers may wish to select the law of a jurisdiction that does not have a franchise or dealer protection law, in an effort to avoid the impact of such law on their termination rights and other aspects of the dealer relationship. Such an effort may succeed, if the jurisdiction chosen bears a reasonable relationship to the transaction, *e.g.*, the supplier's home state. Such choice of law provisions are often disregarded by courts in deference to the public policy of states with franchise laws,[121] or because the validity of the contract containing the clause was questioned.[122]

184442, BUS. FRAN. GUIDE (CCH) ¶ 10,573 (E.D. Pa. 1994) (enforcing Alabama choice of forum in franchise agreement).

114 *Eisaman v. Cinema Grill Systems, Inc.*, 87 F. Supp. 2d 446 (D. Md. 1999).

115 *Moses v. Business Card Express, Inc.*, 929 F.2d 1131 (6th Cir. 1991).

116 *Silverman v. Carvel Corp.*, 2001 U.S. Dist. LEXIS 21095, BUS. FRAN. GUIDE (CCH) ¶12,228 (W.D. N.Y. 2001).

117 *Cadapult Graphic Systems, Inc. v. Tektronix Inc*., 98 F. Supp. 2d 560 (D.C. N.J. 2000) (28 U.S.C. §1404(a) was applied so that valid forum selection clause selecting Oregon was entitled to substantial consideration and enforced against plaintiff in the absence of evidence of fraud or overreaching).

118 *Marel Corp. v. Encad Inc.*, 2001 U.S. Dist. LEXIS 21209, BUS. FRAN. GUIDE (CCH) ¶12,227 (D.P.R. 2001).

119 *See Docksider, Ltd. v. Sea Technology, Ltd.*, 875 F.2d 762 (9th Cir. 1989).

120 *Stawski Distributing Co., Inc. v. Browery Zywiec, S.A.*, 349 F. 2d 1023 (7th Cir. 2003).

121 *See, e.g., Gandolfo's Deli Boys, LLC v. Holman*, 490 F.Supp.2d 1353 (N.D. Ga. 2007) (choice of Utah law violated Georgia's public policy as to permissible scope of noncompetition clause, and would not be enforced); *Ticknor et al. v. Choice Hotels Int'l*, 265 F.3d 931 (9th Cir. 2001) (choice of Maryland law in a motel franchise agreement not enforced based on fact that only contact between franchisor and franchisee took place in Montana, the motel was operated in Montana and Maryland law would have violated Montana public policy); *Guild Wineries and Distilleries v. Whitehall Co., Ltd.*, 853 F.2d 755 (9th Cir. 1988) (giving preclusive effect to administrative ruling refusing to enforce choice of law provision); *Grand Kensington, LLC v. Burger King Corp*., 81 F. Supp. 2d 834 (E.D. Mich. 2000) (Florida choice of law provision in contract between Florida franchisor and Michigan franchisee unenforceable because it significantly eroded franchisee's protection under Michigan

Some courts in recent years, however, have honored the parties' choice, at least in the absence of oppressive use of superior bargaining position, although the overall trend has been mixed.[123] In response to one such decision, Minnesota amended its franchise statute in May 1989 to invalidate any contractual choice of law clause.[124] It remains to be seen whether courts outside of Minnesota will give effect to this provision.

Franchise Investment Law); *Cottman Transmission Systems, LLC v. Kershner*, 492 F.Supp.2d 461 (E.D. Pa. 2007) (choice of Pennsylvania law unenforceable as violation of public policy of California, New York and Wisconsin franchise disclosures laws, would erode quality of protection under those laws); *Caribbean Wholesales and Service Corp. v. US JVC Corp.*, 855 F. Supp. 627, 633 (S.D.N.Y. 1996) (application of contractual choice of New York law would violate public policy of Puerto Rico); *Winer Motors, Inc. v. Jaguar Rover Triumph, Inc.*, 208 N.J. Super. 666, 506 A.2d 817 (N.J. Super. 1986); *South Bend Consumer Club, Inc. v. United Consumers Club, Inc.*, 572 F. Supp. 209 (N.D. Ind. 1983); *R&R Associates of Connecticut, Inc. v. Deltona Corp.*, BUS. FRAN. GUIDE (CCH) ¶ 7526 (D. Conn. 1980); *Instructional Systems, Inc. v. Computer Curriculum Corp.*, 130 N.J. 324, 341-46, 614 A.D.2d 124, 133-35 (N.J. 1992) (choice of California law unenforceable as violating public policy of New Jersey Franchise Practices Act); *Dunes Hospitality, LLC v. Country Kitchen International, Inc.*, 623 N.W.2d 484 (S.D. Sup. Ct. 2001) (choice of Minnesota law disregarded because forum state public policy would be violated and most significant contacts occurred in forum state); *Covert Chevrolet-Oldsmobile, Inc. v. General Motors Corp.* No. 05-00-01170-CV, 2001 WL 950274 (Tex. App. Aug. 21, 2001) (not designated for publication) (Texas law applied to indemnification claim by dealer for costs of lawsuits against it brought in Texas by Texas residents despite choice of law provision selecting Michigan law; Texas had most significant relationship to dispute); *Ingmar GB Ltd. v. Eaton Leonard Technologies, Inc.*, Case C-381/98 (Times Law Report 16.11.00) (the European Court of Justice held that the English Commercial Agents Regulations must be applied where a commercial agent carried on his activities in a member state although the principal was based in a non-member state and the license agreement was governed by California law).

122 *See, e.g., Unarce v. Staff Builders*, BUS. FRAN . GUIDE (CCH) ¶ 10,746 (9th Cir. 1996) (not for publication) (choice of law clause not enforced where validity of agreement containing it is challenged).

123 *See, e.g. JRT, Inc. v. TCBY Systems, Inc.*, 52 F.3d 734, (8th Cir. 1995) (enforcing choice of Arkansas law despite Michigan Franchise Investment Law antiwaiver provision because provision did not specifically address choice of law clauses); *Cherokee Pump & Equipment, Inc. v. Aurora Pump*, 38 F.3d 246 (5th Cir. 1994) (enforcing choice of Illinois law to permit termination of Louisiana distributorship in manner prohibited by Louisiana statute); *Modern Computer Systems, Inc. v. Modern Banking Systems, Inc.*, 871 F.2d 734 (8th Cir. 1989) (enforcing contractual choice of law clause); *Tele-Save Merchandising Co. v. Consumers Distributing Co.*, 814 F.2d 1120 (6th Cir 1987) (same); *Carousel Systems, Inc. v. Ordway*, 1996 WL 208359, BUS. FRAN. GUIDE (CCH) ¶ 10,914 (E.D. Pa. 1996); *Banek Inc. v. Yogurt Ventures, U.S.A., Inc.*, BUS. FRAN. GUIDE (CCH) ¶ 10,112 (E.D. Mich 1992) (enforcing contractual choice of law clause), *aff'd*, 6 F.3d 357 (6th Cir. 1993) (not designated for publication) (state franchise law antiwaiver provision did not preclude enforcing choice of law clause in absence of provision barring such clauses); *Cottman Transmission Systems, Inc. v. Melody*, 869 F. Supp. 1180, 1188 (E.D. Pa. 1994) (enforcing choice of Pennsylvania law, which does not cause substantial erosion of California statutory rights, to dismiss franchisee claims under California Franchise Investment Law); *Hardee's Food Systems, Inc. v. Bennett*, 1994 WL 1372628, BUS. FRAN. GUIDE (CCH) ¶ 10,453 (S.D. Fla. 1994) (enforcing contractual choice of N.C. law, rejecting claim under Fla. franchise statute); *Faltings v. Int'l Bus. Machines Corp.*, 854 F. 2d 1316 (Table), 1988 WL 83316 (4th Cir. 1988) (not designated for publication) (enforcing contractual choice of law clause); *United Wholesale Liquor Co., v. Brown-Forman Distillers Corp.*, 108 N.M. 467, 775 P.2d 233 (N.M. 1989) (enforcing contractual choice of law clause); *Carlock v. Pillsbury Co.*, 719 F. Supp. 791 (D. Minn. 1989) (same); *but see Electrical and Magneto Service Co. v. AMBAC Int'l Corp.*, 941 F.2d 660 (8th Cir. 1991) (refusing to honor contractual choice of law clause); *Wright-Moore Corp. v. Ricoh Corp.*, 908 F.2d 128 (7th Cir. 1990) (same); *Caribbean Wholesales & Service Corp. v. US JVC Corp.*, 855 F. Supp. 627 (S.D.N.Y. 1994) (same); *Flynn Beverage Inc. v. Joseph E. Seagram & Sons, Inc.*, 815 F. Supp. 1174 (C.D. Ill. 1993) (same); *Economou v. Physicians Weight Loss Centers of America*, 1991 WL 185217, BUS. FRAN. GUIDE (CCH) ¶ 9836 (N.D. Ohio 1991) (same); *Scott v. Snelling and Snelling, Inc.*, 732 F. Supp. 1034 (N.D. Colo. 1990) (same); *cf. Pelican State Supply Co., Inc. v. Cushman, Inc.*, 39 F.3d 1184 (8th Cir. 1994) (unpublished opinion) (choice of Nebraska law did not make Nebraska state dealer law applicable to out-of-state dealer, where statute by its terms governed only dealers in Nebraska).

124 Minn. Stat. § 80C.21. *See also* S.D. Laws of 1991, H.B. No. 1044, § 3.

It is also noteworthy that at least one court, the First Circuit, has not only held that Maine's public policy expressed in its wine franchise law voided a contractual choice of law provision, but went so far as to award sanctions against the supplier and its counsel for what it termed a "frivolous" appeal.[125]

The Eighth Circuit has held both ways, suggesting at one point that the determining factor may be whether the federal court faced with the question is being asked to apply the law of the forum state or of another forum.[126] This suggests that a race to the courthouse in the preferred forum may be worth the exercise.

The chosen law should have some relationship to the parties or the performance of the contract. A federal district court in New York has held invalid a choice of law provision that bore no reasonable relation to the parties or contract, applying New York law instead.[127] In selecting a particular state's law, note that this may result in the application of either a more or less restrictive state franchise law than might otherwise be the case.[128] Counsel for suppliers should consider seeking to carve such statutes out of the choice of law selection.

In addition, care should be taken that references in the contract to the provisions of "applicable law" do not result in the application of a state franchise law notwithstanding the contrary choice of law. The Ninth Circuit held that a contract provision applying California law "[e]xcept as otherwise required by applicable law" did not preclude application of an Arizona franchise law, since that was the only other possible "applicable law".[129] Another trap for the unwary drafter was laid by the Ohio Court of Appeals which decided to enforce an arbitration clause in a contract with a severability clause that provided "any provision of this Agreement which in any way contravenes any law of any relevant jurisdiction shall be deemed not to be a part of this Agreement in such jurisdiction." This language was held to require application of California's state law giving a state motor vehicle board authority to determine whether there was good cause for termination.[130]

A better practice that addresses both these decisions would be to refer only to provisions of applicable law that cannot be waived and that are necessarily applicable notwithstanding a contractual

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125 *Solman Distributors, Inc. v. Brown-Forman Corp.*, 888 F.2d 170 (1st Cir. 1989).

126 *Electrical and Magneto Service Co., supra,* at 663-64 (distinguishing *Modern Computer Systems, supra*.

127 *LaGuardia Associates v. Holiday Hospitality Franchising, Inc*., 92 F. Supp. 2d 119 (E.D.N.Y. 2000) (Tennessee choice of law provision between New York franchisee and Georgia franchisor unenforceable for lack of rational relationship to state).

128 *Compare Faltings v. Int'l Bus. Machines Corp.*, 854 F. 2d 1316 (Table), 1988 WL 83316 (4th Cir. 1988) (not designated for publication) (choice of New York law precludes application of more restrictive New Jersey Franchise Practices Act); *Barnes v. Burger King Corp.*, 932 F. SUPP. 1441 (S.D. Fla. 1996) (California franchisee lacked standing to assert claim under Florida Franchise Act, despite contractual choice of Florida law); and *Edelen and Boyer Co. v. Kawasaki Loaders, Inc.*, 1992 WL 236909, BUS. FRAN. GUIDE (CCH) ¶ 10,171 (E.D. Pa. 1992) (Georgia heavy equipment dealer law not applicable to franchises outside Georgia, notwithstanding choice of Georgia law in franchise agreement); *with Tractor and Farm Supply, Inc. v. Ford New Holland, Inc.*, 898 F. Supp. 1198 (W.D. Ky. 1995); *Burger King Corp. v. Austin*, 805 F. Supp. 1007, 1022-23 (S.D.Fla. 1992) (allowing counterclaim by Georgia franchisees under Florida Franchise Act where franchise agreement chose Florida law); *McGowan v. Pillsbury Co.*, 723 F. Supp. 530 (W.D. Wash. 1989) (allowing claim that New York Franchise Sales Act was violated where agreement with Washington franchisee chose New York law); *and Dep't of Motor Vehicles v. Mercedes-Benz*, 408 So. 2d 627 (Fla. 1981), *modified*, 455 So.2d 404 (Fla. 1984) (applying New Jersey Franchise Practices Act to Florida franchise where contract chose New Jersey law).

129 *Sutter Home Winery, Inc. v. Vintage Selections, Ltd.*, 971 F.2d 401, 406 (9th Cir. 1992).

130 *Sterling Truck Corp. v. Sacramento Valley Ford Truck Sales*, 751 N.E.2d 517 (Ohio Ct. App. 2001), *appeal denied*, 748 N.E.2d 547 (Ohio 2001).

choice of other law. Note also the importance of drafting a broadly applicable clause governing the rights of the parties, and not merely governing the agreement.[131]

Note that unless the parties provide otherwise, the United Nations Convention on Contracts for the International Sales of Goods[132] will govern contracts for sales of goods between parties who have their places of business in different Contracting States.[133] Significant differences from the terms which U.S.-based parties might expect include the inapplicability of a Statute of Frauds requirement of a signed writing,[134] unless the parties so require by contract,[135] the rejection of the parol evidence rule,[136] "battle of the forms" issues,[137] and the payment of the prevailing party's attorneys' fees.[138]

Combining a choice of favorable law with an arbitration clause will enhance the likelihood of the choice of law being enforced. The strong federal policy in favor of arbitration, embodied in the Federal Arbitration Act,[139] generally has been held to support the parties' explicit choice of law to be applied in arbitrations, even in the face of explicit state law to the contrary.[140]

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131 *See, Valley Juice Ltd., Inc. v. Evian Waters of France, Inc.*, 87 F.3d 604 (2d Cir. 1996) (choice of New York law to govern agreement did not preclude claim under Massachusetts "little FTC Act," as it would have had the agreement also stated rights of parties were to be governed by New York law); *see also Heating & Air Specialist, Inc. v. Jones*, 180 F.3d 923 (8th Cir. June 7, 1999) (provisions that Texas law governed "interpretation" of contract applied only Texas rules of statutory construction, not Texas substantive law).

132 United Nations Convention on Contracts for the International Sales of Goods, S. Treaty Doc. No. 9, 98th Cong., 1st Sess. 22 (1983), reprinted at 15 U.S.C. app. 52 (1997) (the "CISG").

133 CISG Arts. 1, 6.

134 CISG Art. 11.

135 CISG Art. 29.

136 CISG Art. 8; *MCC-Marble Ceramic Center, Inc. v. Ceramica Noyvo d'Agostino, S.p.A.*, 144 F.2d 1384 (11th Cir. 1998) (parol evidence is to be admitted and considered as to parties' intent, even if the oral conduct contradicts the written contract).

137 CISG Art. 19 (no contract results if acceptance contains terms that materially alter the offer).

138 *Zapata Hermanos Sucesores, S.A. v. Hearthside Baking Co., Inc.*, 2001 U.S. Dist. LEXIS 15191, 2001WL 1000927 (N.D. Ill. 2001) (awarding attorneys' fees to prevailing party under CISG Art. 74 as expenses stipulated by parties as foreseeable to be incurred as a result of breach).

139 9 U.S.C. §§ 1 *et seq.*

140 *See, e.g., Good(E) Business Systems, Inc. v. Raytheon Co.*, 614 F. Supp. 428, 430-31 (W.D. Wis. 1985); *see also Volt Information Sciences, Inc. v. Stanford University*, 489 U.S. 468 (1989) (choice of California law included California rules regarding arbitrability, which were applied to stay arbitration); *Yates v. Doctor's Assocs., Inc.* 140 Ill. Dec. 359, 193 Ill. App. 3d 431, 549 N.E.2d 1010 (Ill. App. 1990).

XXIII. *Contents — Miscellaneous Provisions*

Among the "boilerplate" provisions that should be included in the contract include an "entire agreement" integration or merger clause requiring all changes to be in writing and disclaiming all prior understandings or agreements,[141] a "severability" clause, providing that any provision deemed invalid does not affect the validity of the rest of the agreement and that the offensive provision is to be deemed modified to the minimum extent necessary to make it valid, and a "no waiver" clause providing that the failure to enforce any provision is neither a waiver of that or any other provision nor of the right to enforce the provision in the future.

Note that in New York, a general, true "boilerplate" integration clause may not preclude a fraud claim based on prior oral misrepresentations. Such a clause will be enforced only upon a showing that it was a specific, bargained-for provision. Thus, boilerplate form provisions should be avoided.[142] Rather, the merger clause should refer (but "without limitation") to specific types of representations, disclosures such as prospective earnings, existence of a market, support to be provided, and the like.[143]

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141 But note that under the U.C.C., a merger clause may be disregarded if the written agreement does not reflect the parties intended bargain and so is not the intended "final expression of their agreement." *See L.S. Heath & Son, Inc. v. AT&T Information Systems, Inc.*, 9 F.3d 561, 569 (7th Cir. 1993) (merger clause is not dispositive; ". . . to determine whether the parties intend a writing to be the complete and exclusive agreement between them, a court must compare the writing with the prior negotiations. . . . If the allegedly integrated writing does not, without reference to another document or coordinating information, reveal what the basic transaction entailed, then the writing is not integrated."); *Sierra Diesel Injection Service, Inc. v. Burroughs Corp.*, 890 F.2d 108 (9th Cir. 1989). *See also, Howell v. Oregonian Publishing Co.*, 82 Or. App. 241, 246, 728 P.2d 106, 109 (Ore. Ct. App. 1986), *modified*, 85 Or. App. 84, 735 P.2d 659 (Or. App.), *rev. denied.*, 303 Or. 699, 740 P.2d 1212 (Or. 1987) (written contract may be modified by subsequent oral agreements).

142 *See Caiola v. Citibank, N.A.*, 295 F. 3d 312 (2d Cir. 2002) (holding form merger clause unenforceable as not tracking substance of alleged misrepresentations).

143 *E.g., Dallas Aerospace, Inc. v. CIS Air Corp.*, 2002 WL 31453789, 49 UCC Rep. Serv. 2d 142 (S.D.N.Y. 2002) (disclaimer of representations as to airworthiness precluded claim based on failure to disclose previous damage); *see also Wells Fargo Bank Northwest, S.A. v. TACA International Airlines, S.A.*, 2003 WL 22047886 (S.D.N.Y. 2003) (Courts will compare text of agreements to alleged misrepresentations; general disclaimer that included specific categories of representations disclaimed was enforced.)