ALI-ABA Course of Study
Product Distribution and Marketing

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Distribution Contracts

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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,
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

\(^2\) 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.

arrangement may avoid the impact of these laws. Moreover, if the proposed agreement is with an existing 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.

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. 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 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.

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, while exactly the same contention was rejected in a decision refusing to apply the equivalent Kansas statute retroactively.


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).
