

Minimizing Distributor Terminations: Preparation Is Key

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Don't forget that the cost of litigation is not just the attorneys' fees and out-of-pocket litigation costs that will be incurred, but also includes management and sales personnel time that must be devoted to the case, rather than day-to-day business.



In the first two columns of this series ([Part 1](#) [1], [Part 2](#) [2]), we discussed how to minimize the risks of terminating a distribution relationship before the relationship begins and during the relationship. In this column, we discuss the steps that should be taken when it appears that termination may be necessary, but before a final decision has been made.

Carefully following these steps will ensure that, if termination is ultimately required, it will be done the right way, for the right reasons significantly minimizing the risk of a challenge and a claim for damages.

As we stated in our first column, the best way to minimize the risk of termination is to avoid it altogether. Thus, while termination may appear, at first blush, to be an obvious solution to a problem, careful analysis prior to a final decision may reveal alternatives that carry far less risk.

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Careful investigation and analysis is key. Too often, a termination notice is the first step taken when a distribution relationship goes badly. Only after the dealer pushes back is counsel brought into the loop and the hard questions asked. That, however, should be the first step in the process. Counsel, along with management and/or some other third party not involved on a day-to-day basis can provide an objective analysis of the decision, the process, and potential alternatives that are necessary to making a good decision.

First, gather and review all relevant documents, printed and electronic, regarding the relationship. Make sure the files of everyone potentially having relevant information are searched. Relevant documents include – but aren't limited to: contracts, addenda, and amendments; policy and procedure manuals; field and in-house sales reports; performance evaluations; sales data and comparisons; credit reports and analyses; correspondence; e-mail and attachments; and notes of telephone conversations and meetings.

Don't forget to review smart phones, flash drives, laptops and even home PCs of individuals likely to have responsibility for and contact with the distributor.

Next, meet with knowledgeable company representatives, individually and/or in groups, and conduct preliminary interviews to gather background facts. This includes the field and in-house sales force; sales managers; credit and customer service representatives; management; and legal counsel. *Do not meet with other dealers* as that could lead to claims for conspiracy, tortious interference or even an antitrust claim when the dealer learns about the communication. (The dealer *will* learn about it.)

Based on the information gathered, confirm the reasons for termination and analyze the evidence. Ferret out hidden motives and agendas (personal issues between the dealer and field sales representative, a desire for a specific replacement, etc.). Organize evidentiary support for the termination decision and determine if follow-up investigation is required. Determine if oral representations have been made to the dealer (i.e., contract can be ignored, promised exclusivity, indefinite tenure, etc.) that must be further explored.

Finally, look at whether the problems identified can be remedied. Has assistance in problem areas been offered and provided to the dealer? Have all dealers been treated alike? Should the termination be postponed to give the dealer another chance to build a stronger company file? Have reasonable performance standards been set, agreed to by the dealer, and satisfied? How does the dealer's performance compare to contract requirements, other dealers and the industry? All these questions boil down to a single, ultimate issue: Is the company's action fair? Unless the answer to that question is an unqualified yes, further thought and investigation are required.

Conduct a legal and litigation analysis. If the preliminary investigation reveals that termination would be fair under the circumstances, then review the contract (written and/or oral) to ensure that termination can be accomplished consistent with its terms.

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Review state dealer and franchise statutes, whether of general applicability or directed to a special industry, to determine if a particular law applies (and if so, to some/all of the relationship) and if the proposed termination is in compliance with statutory requirements.

Many states limit termination to good cause, narrowly defined, and prescribe mandatory procedures that must be followed to avoid significant damages claims, as well as injunctive relief. While these statutes are generally described as dealer or franchise statutes, the relationships they govern are often far broader than the generic use of those terms might suggest.

In addition to these broad applicability statutes, many states have statutes that address the distribution relationship in specific industries. The most common are the motor vehicle, alcohol beverage and heavy/industrial/farm equipment industries. But these statutes, too, often cover a much broader range of relationships than their generic descriptions would suggest. This is an area that is fraught with risk and experienced distribution counsel should be consulted to determine the potential applicability, and requirements, of any such statutes.

It is also important to evaluate the likelihood and cost of litigation based on the dealer's past history, reputation, character, personality, other dealer challenges, financial resources, and importance of the line to the dealer. Estimate the dealer's likelihood of success if termination is challenged.

Don't forget that the cost of litigation is not just the attorneys' fees and out-of-pocket litigation costs that will be incurred, but also includes management and sales personnel time that must be devoted to the case, rather than day-to-day business. In addition, under many state statutes, a supplier who loses a challenge to termination also has to pay the dealer's attorneys fees and costs. Other remedies may include inventory repurchase requirements. All of these costs should be taken into account.

Finally, ask whether the company is exposed to a claim beyond wrongful termination, including price discrimination or other antitrust concerns, tortious interference with customer relationships, other breaches of contract or fraud. These claims raise the stakes considerably and may even allow a claim for punitive damages.

Consider alternatives. One alternative that should always be considered is the possibility of rehabilitating the dealer and giving it more time to cure problems. If the relationship is non-exclusive, appointing a new dealer in the territory to compete with the problem dealer may be a good idea. Another possibility is to modify or narrow the dealer's contract to limit its territory or products. Perhaps it would be significantly less expensive and/or disruptive to the channel to buy out the dealer. Like training a new employee, putting a new dealer into a territory is time-consuming and costly and it is important to carefully consider all of the costs and benefits of such a course to determine if the existing relationship can be fixed faster and at a lower ultimate cost.

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While there are a number of steps outlined above, the process will not necessarily be a lengthy one. It will, however, yield a better decision and one that will be far easier to defend, both as a legal and a business matter, if challenged. Thus, whether the process ultimately confirms the initial decision to terminate, or results in a continuation of the existing relationship, all of the parties will be better served.

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