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Drafting Distribution Contracts in the United States: Key Provisions

by

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I. Introduction

Distribution of goods into a market can be accomplished using a variety of methods: direct distribution, commercial agents, independent distributors, private label goods, franchising, and licensing of manufacturing rights, among others. Each of these options raises different legal issues, both regulatory and contractual, which vary widely from nation to nation and region to region.

This paper will examine the principal areas of regulation and key contract provisions applicable for distribution of goods in the United States.

II. Areas of regulation

A. Advertising and Consumer Protection

Advertising in the United States is regulated at both the federal and state levels. The Federal Trade Commission's authority, under § 5 of the Federal Trade Commission Act[1] to regulate unfair and deceptive practices, has made the FTC the principal federal advertising enforcement agency. State unfair and deceptive practices acts and other consumer protection laws give similar authority to the state attorneys general.

Both federal and state authority to restrict unfair and deceptive practices is broad, and can encompass a wide variety of practices. The FTC will act against advertising that it determines is likely to mislead a consumer interpreting the message reasonably and is likely to affect the consumer's purchasing decision.[2] The 1994 amendments to Section 5 of the FTC Act permit the FTC to prosecute unfair practices "likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to

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[1] 15 U.S.C. §45 *et seq.*

[2] *See Kraft Inc. v. FTC*, 970 F.2d 311 (7th Cir. 1992), *cert. denied*, 113 S. Ct. 1254 (1993); *Int'l Harvester Co.*, 104 F.T.C. 949, 1056 (1984).

consumers or to competition."[3] In recent years, the FTC has focused its efforts on advertising claims that are more difficult for consumers to verify, such as environmental benefits, health benefits, particularly in the area of drugs, devices, weight loss products, and dietary supplements, and food claims. Its enforcement priorities also include alcoholic beverages, infomercials and 900 numbers.

Many states, however, continue with a broader approach to deceptive advertising enforcement, using the standard of protecting "the ignorant, the unthinking and the credulous, who, in making purchases do not stop to analyze but are governed by appearances and general impressions."[4] Intent is not an element of an offense, and hiding critical disclosures in the "fine print" will not save an advertisement whose overall impression is misleading. The case law under state consumer protection laws makes clear that, unlike a common law fraud action, intent to deceive, reliance, and damages are not required elements of an action under consumer protection laws.[5]

The basic rule for advertising is that facts, demonstrations, tests, endorsements, surveys, guarantees and other methods used by advertisers to sell their products to consumers must be substantiated by hard data. If a claim is objectively provable (in contrast to mere "puffery," such as "world's best coffee"), whether the claim is explicit or implied, substantiation is required and must be in hand before the claim is made, not generated after the fact.

B. Unfair competition

Unfair competition, like most private party litigation for false advertising, is often based on Section 43(a) of the Lanham Act. The elements of a Lanham Act claim include: (i) a false representation of fact, including claims which have a tendency to mislead even if literally true[6]; (ii) that is material, *i.e.*, likely to influence purchasing decisions; (iii) misleads a substantial segment of the target audience[7]; (iv) affects interstate commerce; and (v) is likely to be injure the plaintiff. Again state unfair competition laws are similar, covering conduct that amounts to a "passing off" of one firm's goods for another or a misappropriation of another firm's goodwill. Although most unfair competition cases involve claims of this nature, the coverage of unfair competition law is broad, and not necessarily so limited.

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3 FTC Unfairness Policy Statement, appended to *Int'l. Harvester Co.*, 104 F.T.C. 949, 1070 (1984).

4 *Florence Mfr. Co. v. J.C. Dow & Co.*, 178 F.2d 73, 75 (2d Cir. 1910) (L. Hand).

5 *See, e.g.*, *Fletcher v. Security Pacific National Bank* 23 Cal.3d 442, 451 (1979); *People v. Superior Court (Olson)*, 96 Cal.App.3d 181, 190, 198 (1979), *cert. den.* 446 U.S. 935 (1980); *Ball v. American Trial Lawyers Assn.*, 14 Cal.App.3d 289, 310 (1971); *People ex rel. Mosk v. Lynam*, 253 Cal.App.2d 959, 965-66 (1967); *People v. Wahl*, 39 Cal.App.2d Supp. 771, 773 (1940).

6 *See, e.g.*, *William H. Morris Co. v. Group W. Inc*. 66 F.3d 255 (9th Cir. 1995); *American Home Products Corp. v. Johnson & Johnson*, 577 F.2d 160, 165 (2d Cir. 1978).

7 *See, e.g.*, *McNeilab, Inc. v. American Home Products Corp.*, 501 F. Supp. 517, 528 (S.D.N.Y. 1980) ("not insubstantial number of consumer receive a false or misleading impression" (23%)).

C. Antitrust/Competition Law

1. *Resale Price Maintenance*

In general, U.S. antitrust laws, in the absence of monopoly power, are concerned with concerted action, not unilateral conduct. Moreover, concerted action among competitors – "horizontal" conduct – is generally considered *per se* unlawful, meaning that economic or other justifications will not be heard. Until 2007, the same was true for vertical agreements – that is, agreements between buyer and seller – that set a minimum resale price for the affected product. The Supreme Court overturned that rule in the landmark decision, *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*[8] Now all vertical agreements, whether related to pricing or to non-price matters such as territorial restrictions, are judged under federal law by the "rule of reason," under which the court must determine whether the anticompetitive harm from the conduct is outweighed by potential competitive benefits.[9] The proof required of a plaintiff in a rule of reason case is generally much greater, as are the costs of litigation.

State antitrust laws vary, however. Some states follow federal law, others view federal law as relevant, but not controlling, authority, and in some states, among them California, Maryland, New Jersey, and arguably New York, state antitrust laws are entirely independent of federal law and continue to apply a *per se* rule against resale price maintenance.

Moreover, even under federal law, the Supreme Court in *Leegin* stressed several situations in which resale price maintenance could be found to be anticompetitive, such as where resale price maintenance is initiated by dealers rather than suppliers; where most suppliers in an industry use resale price maintenance; and where either the supplier or dealer involved has market power. Note, however, that where distribution is accomplished through a true agent, who does not take title to the product, sales are therefore made directly by the supplier to the customer procured by the agent, and the supplier is free to control that price, as it is a unilateral act of the supplier, not an agreement with the agent.

2. *Most Favored Customer Provisions*

Most favored customer clauses typically provide that one party to a contract will deal with the other party on terms that are no less favorable than the best terms on which the first party deals with others. In the distribution context, such clauses are typically invoked by distributors requesting distribution rights to products on prices and terms no worse than those offered to others.

While most favored customer clauses are widespread, and courts generally have found that such clauses do not unreasonably restrain trade, the Department of Justice filed an action in 2010 in the United States District Court for the Eastern District of Michigan against Blue Cross Blue Shield ("BCBS"), claiming their use of such clauses thwarted competition in violation of

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8 551 U.S. 877, 127 S. Ct. 2705 (2007). It remains to be seen how lower courts will interpret *Leegin*, as the Supreme Court took pains to observe that there were circumstances in which resale price arrangements would be found to be anticompetitive and unlawful.

9 *See generally Continental T.V. Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977).

antitrust laws.[10] The Attorney General found that, in the context of its market power, BCBS harmed competition by using clauses in which hospitals agreed to charge other insurers more than they charged BCBS, sometimes as much as 40 percent more.[11] (The case was voluntarily dismissed by the Justice Department after the state of Michigan passed a law prohibiting health insurers from using most-favored-customer clauses).

And in the *Apple Computer* e-books case,[12] a federal district court found that a most-favored-customer provision in Apple's contracts with publishers that required the publishers to lower the price at which they sold e-books in Apple's store if the books were sold for less elsewhere – notably by Amazon.com – violated the antitrust laws. The decision was affirmed on appeal by the U.S. Court of Appeals for the Second Circuit. Apple sought U.S. Supreme Court review; however, the Court declined to review the decision. The presence of most favored customer clauses can also lead to a supplier rejecting an otherwise attractive offer to take surplus inventory at a lower price, because the discounted price would have to be offered to all customers with a most favored customer clause.[13]

The presence of most favored customer clauses can also lead to a supplier rejecting an otherwise attractive offer to take surplus inventory at a lower price, because the discounted price would have to be offered to all customers with a most favored customer clause.[14] Contract drafters should therefore examine whether a most favored customer clause raises antitrust risks in the context of their client's particular market share and pricing practices.

3. *Territorial and Customer Restrictions*

Customer and territory restrictions, such as exclusive territories pursuant to which a distributor is allocated a specific territory outside of which it may not sell and within which no other distributor may sell the supplier's goods are governed by the rule of reason. Exclusive territories, by definition, reduce intrabrand competition between distributors of the same products. But by eliminating one distributor "free-riding" on the promotional and service efforts of another and undercutting its price, and thus making it feasible for the distributor to sustain those efforts, exclusive territories enhance interbrand competition between suppliers of competing products, and so are usually viewed as procompetitive on balance.[15] This is in sharp

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[10] *U.S. et al. v. Blue Cross Blue Shield of Michigan*, (Case No. 10-cv-14155, E.D. Michigan), complaint *available at* https://www.justice.gov/atr/case-document/file/489536/download.

[11] *See* Bell, "Antitrust Suit Puts Most Favored Nation Users on Notice," *available at* Law 360.

[12] *United States v. Apple Inc.*, 952 F. Supp. 2d 638 (S.D.N.Y. 2013).

[13] *See* T. Ananda, "Contracts that Reference Rivals – the Latest Guidance from to DOJ," *The Antitrust Counselor* (ABA Section of Antitrust Law) (July 2012) at 19.

[14] *See* T. Ananda, "Contracts that Reference Rivals – the Latest Guidance from to DOJ," *The Antitrust Counselor* (ABA Section of Antitrust Law) (July 2012) at 19.

[15] *See Continental T.V., Inc. v. G.T.E. Sylvania, Inc.*, 433 U.S. 36 (1977); *Graphic Products Distributors Inc. v. Itek Corporation*, 717 F.2d 1560 (11th Cir. 1983).

contrast to the situation in Europe, in which such territorial restrictions are viewed as antithetical to the common market.

4. *Predatory Pricing – Below-Cost Sales*

A supplier's sales below cost are unilateral in nature, and so do not violate the antitrust laws except in the context of monopolization or an attempt to monopolize under § 2 of the Sherman Act. To constitute such a violation, predatory pricing must be at a level below marginal or average variable cost.[16] In addition, market structure must be such that the alleged monopolist will be able to recoup its losses by increasing prices to above-competitive levels after driving its competitor out of business. A market with low barriers to entry, for example, is an unlikely candidate for a predatory pricing claim, because a new entrant could readily prevent supra-competitive pricing.

5. *Refusals to Deal*

Again, in the absence of monopolization under § 2, only joint refusals to deal are actionable under the antitrust laws. In general, suppliers are entirely free to select those with whom they wish to do business, even if that decision is based upon compliance with pricing policies.[17] Decisions not to do business with certain customers must, however, be made unilaterally, and never jointly with competitors. Even a decision not to deal with a distributor made at the behest of another distributor carries potential antitrust risks, and should be undertaken only after consultation with counsel.

Accordingly, suppliers should avoid circumstances in which they terminate a distributor in response to the request of a number of that distributor's competitors. In those circumstances the claim might be asserted that the supplier was acting as a member of a horizontal conspiracy of the competing dealers.[18]

In general however, the antitrust laws are designed to protect competition, not individual competitors, and in the absence of concerted action, a supplier's decision to replace one distributor with another does not implicate the antitrust laws.[19]

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[16] *See, e.g., William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 668 F.2d 1014, 1041 (9th Cir. 1981), *cert. denied*, 459 U.S. 825 (1982). ("If the plaintiff does prove pricing below average variable cost, the burden shifts to the defendant to establish a legitimate business justification for its conduct.")

[17] *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919); *Russell Stover Candies, Inc. v. Federal Trade Commission*, 718 F.2d 156 (8th Cir. 1983).

[18] *E.g., Lovett v. General Motors Corp.*, BUS. FRAN. GUIDE (CCH) ¶ 9860 (D. Minn. 1991); *see also Denny's Marina v. Renfro Productions, Inc*., 8 F.3d 1217 (7th Cir. 1993) (boat show's exclusion of marina in response to complaints by marina's competitors of price-cutting was horizontal price-fixing conspiracy and so a *per se* violation); *Malley-Duff v. Crown Life*, 734 F.2d 133, (3rd Cir. 1984) (termination of insurance agent was horizontal group boycott, and so per se, where insurance carrier officer who made termination decision was behind-the-scenes principal in new agency that took over the territory, so termination decision was horizontal decision of competitor, not independent vertical decision of carrier).

[19] *E.g., Joseph E. Seagram & Sons, Inc. v, Hawaiian Oke & Liquors Ltd*., 416 F.2d 71 (9th Cir. 1969), *cert. denied* 396 U.S. 1062 (1970).

6. *Price discrimination*

Broadly speaking, under the Robinson-Patman Act,[20] price discrimination is prohibited. A supplier cannot sell the same product to different competing purchasers at different prices if the effect is anticompetitive. The big purchaser may not be favored over the small one. Any quantity discounts must be cost-justified, and, because this defense is particularly difficult to establish, should be approved by counsel. Prices may be lowered to meet, but not beat, a competitor's price, but only if there is a good-faith basis for believing that the competitor actually made a lower offer. The lower price must not, however, be confirmed with the competitor.[21]

The Robinson-Patman Act also requires promotional programs, services and allowances to be available to customers on a proportionally equal basis. In general, to the extent possible, suppliers should consult with counsel on price-discrimination and promotional program issues because of the complexity of the law and the importance of the factual context.

7. *Franchising*

Franchising is heavily regulated in the United States, both by the Federal Trade Commission and by the individual states. Many states have business franchise laws or other dealer protection statutes that restrict termination and non-renewal (notwithstanding the terms of an agreement) or impose disclosure or registration requirements. Some three-quarters of the states have general statutes regulating franchises, business opportunities or both.[22]

a. *Types of Statutes.*

Some of these state laws require specified detailed disclosures and sometimes registration with state authorities.[23] (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.[24] In addition to these general laws, many states have laws applicable to specific industries, such as petroleum products, motor vehicles, farm equipment, alcoholic beverages and office equipment. Petroleum products and automobile dealers are also protected by federal statutes.[25] The legislative motivation behind the franchise laws is much the same as that behind securities laws:

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[20] 15 U.S.C. §§13, 13a, 13b, 21a.

[21] *See United States v. United States Gypsum Co.,* 438 U.S. 422 (1978).

[22] For a broader discussion of franchise regulation, see the author's article, "The Broad Scope of Franchise Laws: Traps for the Distribution Contract Drafter," *available at* http://www.thsh.com/Publications/Other-Publications/The-Broad-Scope-of-Franchise-Laws-Traps-for-the-.aspx#.V0X03fkrKUl.

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

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

[25] 15 U.S.C. §§ 1221 *et seq*. (automobile dealers); 5 U.S.C. §§ 2801 *et seq*. (motor fuel).

the franchisee is viewed as an investor entitled to certain information and safeguards. Violation of these statutes is usually a criminal offense and gives rise as well to civil liability of the franchisor to injured franchisees.

The statutes take one or both of two general forms – (1) disclosure and registration requirements, and (2) restrictions on termination and other substantive aspects of the distribution relationship. The theory of the disclosure and registration laws is that the franchisee should be given essential information regarding what is considered to be his business "investment." The theory underlying the anti termination laws is that a distributor who has invested in a supplier's brand and has built up a market should be protected from a supplier's decision to yank the rug out from under him by giving the now established market to another distributor or taking it over directly.

b. *Applicability*.

i. *"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,[26] or substantial association with such a mark[27] or, in some cases, the mere right to sell goods or services using the mark.[28] Second, there is usually a marketing element — either a community of interest between franchisor and franchisee in the marketing of goods or services,[29] or a marketing plan prescribed by the franchisor.[30] And third, there is often, but not always, a franchise fee element.[31]

ii. *"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.[32]

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

[27] *See*, *e.g.*, Calif. Corporations Code § 31005(a)(2).

[28] *See*, *e.g.*, Mich. Comp. Laws § 445.1502(3)(b).

[29] *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.

[30] *See*, *e.g.*, Calif. Corporations Code § 31005(a)(1).

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

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

iii. *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.

c. *Disclosure Requirements*

The FTC Rule and many state laws require that a very extensive disclosure document be provided to prospective distributor franchisees. Among the information that must be provided are the franchisor's audited financial statements, information about the franchisor's history, including litigation and bankruptcy history and operating experience, a description of the franchisor's termination rights, and restrictions on the business that the franchisee may conduct. There are also very specific restrictions on earnings claims. As a result of these restrictions, such claims or projections are generally not made. The states with franchise disclosure laws generally require similar documents not only to be provided to prospective franchisees, but also to be filed with, and often approved by, state authorities.

d. *Substantive Restrictions*.

Most state franchise laws also regulate certain substantive provisions of the relationship between franchisor and franchisee, particularly with respect to termination. Of the states with franchise laws restricting termination rights, a few, such as Mississippi, merely require that a specified minimum notice be given.[33] Most, however, require not only minimum notice and opportunity to cure, but also 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*.[34] 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.

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.[35] "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.[36]

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.[37] Some state laws also restrict other aspects of the franchise relationship, such as restrictions on changes in management or ownership, requirements that goods or services be

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[33] *See, e.g.,* Miss. Code §§ 75-24-51 to 75-24-61.

[34] *See, e.g.,* Minn. Stat. § 80C.14(b).

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

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

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

obtained from the franchisor, discrimination among franchisees in price, credit terms, services and the like, unreasonable performance standards, or increases in prices without notice.[38]

Many statutes prohibit any waiver by the franchisee of its statutory rights.[39]

8. *Dealer Termination*

While termination of distributors and dealers will generally be permitted in accordance with contractual provisions, such termination is one of the most frequent sources of litigation under the antitrust laws and related state statutes and common law. It is thus important that company records adequately and accurately reflect the reasons for termination, but such documentation should be reviewed by counsel. Inconsistent application of standards for termination will lend support to a distributor's claim that the stated ground for termination was pretextual and that the actual reason was some unlawful one. It is also important that termination not be threatened, explicitly or implicitly, without legal investigation and advice.

Terminations that are performed in an unconscionable or unfair manner may be actionable as well. For example, the United States Court of Appeals for 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.[40] In contrast, where clear notice was given of the reasons for termination and the steps needed to be taken by the dealer to cure its defaults, the manner of termination was proper and the termination upheld.[41]

Similar concerns militate against the pre-termination gathering of customer and sales data or inappropriate customer contacts, which could lead to a claim of misappropriation of trade secrets, unfair competition or defamation.

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.[42] This suggests that suppliers may want to include a representation by the distributor that it already had all the resources necessary to perform the

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[38] *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).

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

[40] *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).

[41] *Haagen-Dazs v. Masterbrand*, BUS. FRAN. GUIDE (CCH) ¶ 9570) (S.D.Ga.1989) (S.C. law).

[42] *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 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).

agreement, or an acknowledgment that termination is permitted at any time and that any "investment" is made voluntarily by the distributor with that understanding.

It is worth noting that under some circumstances, a terminating supplier may find itself liable for a business tort or tortious interference with contract or with prospective economic advantage.[43] In addition, some courts have invoked the doctrines of fraud, breach of fiduciary duty or unconscionability in the termination context.[44] Moreover, some courts have held written contractual provisions to be superseded by oral representations.[45]

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[43] 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); *Halebian v. Roppe Rubber,* 718 F. Supp. 348 (D.N.J. 1989) (introduction of policy against transshipping might be tortious interference with relationship with customers distributor previously dealt with but was forbidden to sell to under new policy); *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).

[44] *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.

[45] *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).

In light of the variety of state law restrictions on termination, nonrenewal, and modification − such as appointment of additional dealers − of certain distributor arrangements, it is particularly important not to act without counsel. State "franchise" and "business opportunity" statutes often are far broader in scope than their names might indicate, and care should be taken to consider their impact before initiating or altering distributor arrangements. Special dealer protection laws exist in some states for certain industries. Legal advice is desirable even for the addition of distributors, so that the client is fully aware of the consequences of that step in the particular state and so that efforts, including careful contract drafting and perhaps restructuring of the details of the relationship, can be made to avoid falling within any state distributor protection laws.

III. Key contract issues

A. General Concerns

Except for the franchise and special industry situations referred to above, distribution relationships in the United States are generally governed by contract. The distribution agreement is the critical document defining the rights and obligations of the parties, and thus must be drafted carefully, with a full understanding of the business relationship intended and each party's objectives.

1. *Supplier Objectives*

In general, 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.

2. *Distributor Objectives.*

In turn, 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.

The most important distribution agreement provisions are addressed below.[46]

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[46] This is not intended to be a comprehensive treatment of all of the provisions of a distribution contract. For a more complete discussion, see the author's article, "Distribution Contracts" available at http://www.thshlaw.com/Publications/DistributionContracts.pdf.

B. 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.[47]

C. Definition of Territory

1. *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. As noted above, 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.[48] In most cases such territorial restrictions will be upheld. 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.

2. *May Others Sell in this Territory?*

The distributor may be granted exclusive rights in the territory, or the supplier may sell to others.[49] The distributor may require the supplier to provide protection against "gray market"

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47 *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).

48 *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.

49 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).

imports from other distributors outside the Territory.[50] 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.[51] (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.)[52] 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.[53]

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

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[50] Another way to protect against gray market goods from abroad is illustrated by the case of *Costco Wholesale Corp. v. Omega S.A.*, 131 S.Ct. 565 (December 13, 2010), involving the importation and sale in the U.S. by Costco of Swiss-made Omega watches without Omega's consent. The U.S. Supreme Court, by a 4-4 decision of no precedential value, upheld the decision of the Ninth Circuit, holding that Costco could not rely on the "first sale" doctrine as a defense to a copyright claim when it sold unauthorized Omega watches bearing a copyrighted image that Costco imported from Omega's distributors abroad. The "first sale" doctrine generally holds that once a copyright owner makes an initial sale of a copy of a work, it cannot prevent the buyer from reselling that specific copy to whomever it wants. For now, for foreign made goods, however, at least in the 9th Circuit, a copyright owner can prevent the importation and sale in the U.S. of goods bearing the copyright that were manufactured abroad. On remand, however, the district court determined that Omega's offensive use of its copyright as a sword constituted copyright misuse, based upon Omega's concession that one of the purposes of its copyright registration was to restrict importation of the watches. *Costco Wholesale Corp. v. Omega S.A.*, CV 04-05443 TJH (C.D. Cal. Nov. 9, 2011). That decision is on appeal, has been argued and is awaiting decision. *Omega S. A.v. Costco Wholesale Corp.* (Nos. 11-57137 and 12-56342 (9th Cir.).

[51] *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.

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

[53] *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).

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.[54]

D. E-Commerce

As e-commerce distribution continues to grow in volume and importance, suppliers need to make sure they are protected against unintended or unforeseen distribution of their product by providing for e-commerce distribution methods and standards in their agreements with distributors. Suppliers who do not yet want their product marketed broadly online, 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. By the same token, distributors will want to restrict e-commerce sales both by the supplier and through e-commerce intermediaries like Amazon, or at least be compensated for such sales into its territory.

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.

Notably, in Europe a blanket prohibition on e-commerce sales is generally unlawful. The Court of Justice of the European Union has held that a contract clause amounting to an outright prohibition of on online sales was unlawful under French and EU competition law.[55] In that case the supplier required that its cosmetics and personal care products be sold only in a physical store with a pharmacist present. The Court held that the prohibition of online sales was presumed to be unlawful under Section 101(1) of the Treaty on the Functioning of the European Union unless objectively justified by a showing that the ban is for a legitimate purpose. It rejected the purpose offered of maintaining a luxury image. It also found the online sales ban to constitute an illegal restriction of passive sales. It remanded the case for a determination of whether the policy could be justified by an "individual exemption under Article 101(3) of the Treaty through a showing that the benefits to consumers from the agreement outweighed its anticompetitive effect.

If a supplier accepts distributors selling through online channels, it should set standards for such distribution in its distribution agreements. Depending upon their concerns and their product, suppliers may limit online 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. 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.

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

[55] *Pierre Fabre Dermo-Cosmétique v. President de l'Autorité de la Concurrence*, Case C-439/09 (Ct.Just.E.U. October 13, 2011), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62009CJ0439:EN:HTML.

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, or to pay a profit passover or invasion fee to the distributor into whose territory sales are made.

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.

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 maintain appropriate security safeguards to protect such data, 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.[56] 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. The European GDPR[57] applies to all data collected on European residents, and the California Consumer Privacy Act of 2018, which goes into effect on January 1, 2020, imposes similar regulation of data from California residents.[58]

E. Pricing, Payment Terms and Execution

The supplier's pricing to the distributor 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. Where a distributor's customers require minimum notice of price increases – as, for example, many chain retailers do – the distributor must make sure it gets similar notice from the supplier. 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

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[56] 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.

[57] General Data Protection Regulation 2016/679, *available at* https://gdpr-info.eu.

[58] Assembly Bill No. 375, *available at* https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201720180AB375

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.

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."[59] The federal Electronic Signatures in Global and National Commerce Act[60] ("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.

F. 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 for some period 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.[61]

To be enforceable, such clauses generally must be "ancillary" to the agreement and in furtherance of the agreement's lawful purposes.[62] Courts have applied a reasonableness standard

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

[60] Pub. L. 106-229 (2000).

[61] *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).

[62] *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").

in assessing whether a noncompete clause is enforceable, taking into consideration (i) the length of time,[63] geographic area, and activities restricted; (ii) the hardship to the distributor; and (iii) the public interest.[64] As an alternative to 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.

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.[65] Some states, however, prohibit or limit such post-term noncompete clauses by statute.[66] And other states have invalidated overbroad restrictions in franchise agreements on public policy grounds.[67]

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[68].

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[63] 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).

[64] *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).

[65] *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).

[66] *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).

[67] *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).

[68] *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

The supplier may also wish to 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, without requiring a bond. Distributors may want these matters to be subject to the usual proof.

G. Restrictions on Transfer, Changes is Ownership, Control and Management

The supplier may wish to restrict assignment or transfer 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 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.[69]

H. 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.[70] 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.[71]

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

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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).

[69] *See, e.g.*, Mich. Comp. Laws § 445.1527(g).

[70] *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).

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

specify how any recovery for damages from infringement is to be divided between supplier and distributor. Generally such damages belong to the supplier, but distributors may suffer harm from infringement as well, and may wish to reserve the right to collect damages for such harm. The same is true for any other intellectual property that may be licensed.[72]

I. 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 Massachusetts case holding Mack Trucks' disclaimer of the implied warranty of merchantability enforceable as against a subsequent purchaser without notice.[73]

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 for 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.

J. 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.[74] 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.[75] Other

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[72] *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).

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

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

[75] *See, e.g., See, e.g., Southern Wine and Spirits of Nevada v. Mountain Valley Spring Co., LLC,* Nos. 12-1857 and

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.[76]

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.[77] 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.

K. Termination

1. *Grounds*

The parties will generally wish to specify the basis on which the agreement may be terminated. State laws may restrict these grounds. [78] Among the issues to be considered are the following:

a. *Without Cause*. May either party terminate without cause? If so, this should be explicitly stated. [79]

b. *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 in 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

12-1915 (8th Cir. April 5, 2013), *available* at media.ca8.uscourts.gov.opndir/13/04/121857P.pdf; *Zee Medical Distributor Association, Inc. v. Zee Medical, Inc.*, 94 Cal. Rptr. 2d 829, 2000 Cal. App. LEXIS 307 (2000). *Zee Medical Distributor Association, Inc. v. Zee Medical, Inc.*, 94 Cal. Rptr. 2d 829, 2000 Cal. App. LEXIS 307 (2000).

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

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

[78] *See*, *e.g.*, Cal. Bus. & Prof. Code § 20020 *et seq*.

[79] But see notes 4 and 5 above and accompanying text.

agree on new minimum standards for a renewal term, while distributors should resist such a provision.

Courts may examine the reasonableness of performance standards.[80] 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.[81] 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.[82]

c. *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 non-curable.

d. *Changes in Ownership and Control*. The supplier may provide that a change in ownership, management, or control of the distributor without supplier consent 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. Distributors may wish to exclude transfers among existing owners, or to their family members, from the obligation to obtain consent.

e. *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 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.[83] 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

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[80] *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.

[81] *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).

[82] 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).

[83] 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).

had knowledge of the insolvency at the time of termination.[84] 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.[85] Note that defaults by the distributor after bankruptcy may provide independent grounds for termination.[86]

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.[87] 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."

Until 2019, the rule for trademark licenses was unclear. But in May 2019 the U.S. Supreme Court decided *Mission Product Holdings, Inc. v. Tempnology, LLC*,[88] holding that a bankrupt licensor that rejects a license under Section 365 has breached the license agreement, but cannot rescind it. Thus, the licensee may continue to use the licensed mark (and continue to pay royalties), and may seek from the bankrupt estate any damages caused by the rejection.

f. *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.[89]

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

[85] *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).

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

[87] 11 U.S.C. § 365(n).

[88] No. 17-1657, 597 U.S.___, 2019 U.S. Lexis 3544 (May 20, 2019).

[89] *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).

2. *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.

3. *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, while termination for the distributor's breach might impose a restrictive covenant.

4. *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.

5. *Compensation*

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 the 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.[90] In contrast, such compensation is less common for wine and spirits, a distinction perhaps lacking in any internal logic, other than the greater prevalence of franchise laws protecting beer distributors.

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

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[90] *E.g.*, N.Y. Alc. Bev. Law §55-c; New Jersey Malt Alcoholic Beverage Practices Act, N.J.S.A §§33:1-93.13 *et. seq*.

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.

L. Arbitration

Counsel should consider whether a provision for arbitration is desirable. If included, such a provision will generally be enforced under the Federal Arbitration Act, even in the face of state law to the contrary.[91] Although domestic antitrust claims were at one time considered not to be arbitrable, courts now generally enforce arbitration agreements even in this area.[92] Note,

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[91] 9 U.S.C. §§1 *et seq.* *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 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).

[92] *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

however, that where state franchise 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.[93]

1. *Limitations on Awards*

Suppliers should consider limiting the relief the arbitrators may award to actual compensatory damages in the amount of ascertainable injury, expressly precluding punitive damages[94], 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.[95] In addition, suppliers should consider including language denying preclusive, or

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Cir. 2004).

[93] *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).

[94] 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. *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). 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. *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). 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.

[95] *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.

collateral estoppel, effect to issues resolved by arbitration with one distributor in later proceedings with other distributors.

2. *Choice of Forum*

Courts generally will also enforce a provision for a particular arbitration forum.[96] 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; a terminating supplier may simply stop selling.

3. *Potential Disadvantages*

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. 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 its treatment of similarly situated distributors elsewhere. Preliminary injunctive relief may be less readily available in arbitration, thus precluding a distributor from forestalling a termination while the dispute is resolved.

Finally, 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, although some arbitral providers offer an internal appeal mechanism to another panel of arbitrators, if the parties choose to opt into such a procedure.[97] 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.

4. *Avoiding Overly One-Sided Arbitration Clauses*

Care should be taken in drafting arbitration clauses not to overreach. For example, the Ninth Circuit held an arbitration clause unconscionable, and so unenforceable, where franchisees were required to arbitrate, but the franchisor could proceed in court.[98] And a district court in

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.*

[96] *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).

[97] *See, e.g.*, https:///www.jamsadr.com/appeal.

[98] *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

California rejected an arbitration clause on unconscionability grounds, where the arbitration clause blocked class adjudication and proved to be unfavorable for plaintiffs based on a cost-benefit analysis of arbitration.[99] In response to cases like these, it is prudent to adopt a more balanced approach in drafting arbitration provisions. For example, eBay now uses a bifurcated approach, where the mandatory venue is in a Santa Clara County, California court, but if the dispute amount is less than $10,000, the plaintiff can select arbitration that does not involve in-person hearings. This method creates a "fast-track" arbitration mechanism for small disputes, while still keeping the important disputes in eBay's home court, and has been upheld by a Texas court. [100]

M. 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.[101] 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 choosing a different state's courts on the ground that the public-policy interests of the distributor's state outweigh the parties' choice.[102] Note also that state franchise laws may expressly prohibit the choice of another state

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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).

[99] *Comb v. PayPal*, 218 F.Supp.2d 1165 (N.D. Cal. 2002);

[100] *In re eBay, Inc.*, 2010 WL 2695803 (Tax. App. Ct. July 8, 2010), *reported in* http://blog.ericgoldman.org/archives/2010/07/ebay_venue_sele.htm.

[101] *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).

[102] *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)

as a forum.[103] 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),[104] at least where the choice is between two federal districts. For example, the District of New Jersey has relied on federal law in granting a motion to transfer to the forum identified in the parties' forum selection clause.[105]

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.[106] The Maryland courts have similarly held that a forum selection clause favoring the 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.[107] And 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.[108] 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.[109] 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.[110]

(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).

103 *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.

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

105 *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).

106 *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 184442, BUS. FRAN. GUIDE (CCH) ¶ 10,573 (E.D. Pa. 1994) (enforcing Alabama choice of forum in franchise agreement).

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

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

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

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

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.[111] 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.[112]

N. 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. While a number of courts have disregarded such choice of law provisions in deference to the public policy of states with franchise laws,[113] or because the validity of the contract containing the clause was questioned,[114] some courts in recent years have honored the parties' choice, at least in the absence of oppressive use of superior bargaining position, although the overall trend has been mixed.[115] In response to one such

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

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

[113] *See, e.g., Instructional Systems, Inc. v. Computer Curriculum Corp.*, 130 N.J. 324, 341-46, 614 A.D.2d 124, 133-35 (N.J. 1992); *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); *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); *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). *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).

[114] *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).

[115] *See, e.g. JRT, Inc. v. TCBY Systems, Inc.*, 52 F.3d 734, (8th Cir. 1995) (enforcing choice of Arkansas law despite

decision, Minnesota amended its franchise statute in 1989 to invalidate any contractual choice of law clause selecting other law.[116] It remains to be seen whether courts outside of Minnesota will give effect to this provision.

The Michigan courts have found that a Florida choice of law provision in a contract between a Florida franchisor and Michigan franchisee was unenforceable because the choice of law provision significantly eroded the franchisee's protection under the Michigan Franchise Investment Law.[117] Moreover, 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.[118]

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.[119] This suggests that a race to the courthouse in the preferred forum may be worth the exercise.

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).

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

[117] *Grand Kensington, LLC v. Burger King Corp*., 81 F. Supp. 2d 834 (E.D. Mich. 2000).

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

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

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.[120] 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.[121] 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".[122] Another trap for the unwary drafter was laid by the Ohio Court of Appeals which declined 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.[123]

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 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.[124]

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[120] *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).

[121] *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).

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

[123] *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).

[124] *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

Note that unless the parties provide otherwise, the United Nations Convention on Contracts for the International Sales of Goods[125] will govern contracts for sales of goods between parties who have their places of business in different Contracting States (of which the U.S. is one).[126] 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,[127] unless the parties so require by contract,[128] the rejection of the parol evidence rule,[129] "battle of the forms" issues,[130] and the payment of the prevailing party's attorneys' fees.[131]

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,[132] 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,[133] although there have been decisions requiring arbitration, even in foreign countries, but still requiring the application of local law that forbade parties from opting out of its terms.[134]

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contract applied only Texas rules of statutory construction, not Texas substantive law).

[125] 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").

[126] CISG Arts. 1, 6.

[127] CISG Art. 11.

[128] CISG Art. 29.

[129] 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).

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

[131] *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).

[132] 9 U.S.C. §§ 1 *et seq.*

[133] *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).

[134] *Stawski Distributing Co., Inc. v. Browary Zywice, S.A.*, 349 F. 3d 1023 (7k Cir. 2003).