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BLOGS

System Standards/Change

Distribution Changes Provide Biggest Risks for Manufacturers

As we see in some of the cases summarized above, change tends to leave some former distribution partners or would-be competitors on the outside looking in. It is in these situations when disputes, threats, and even litigation can result. In these same situations, therefore, the manufacturer is best served by having clear documentation in its files, having had legal compliance programs in place, having trained its employees how not to violate antitrust laws and other legal boundaries, and having understood and followed rules relating to pricing, exclusivity, and termination.

Changes and the resulting conflicts most frequently arise in the following scenarios:

- The manufacturer starts “selling direct” rather than through intermediaries.
- “Fewer, stronger dealers” is adopted as a business strategy.
- The company believes it can grow market share best through a dedicated sales force it employs rather than through independent sales representatives.
- After a merger or acquisition, the manufacturer consolidates distribution.

In these scenarios, the manufacturer faces both business and legal risks. On the business side, what if existing distributors, dealers, or sales representatives have relationships with end users that allow them to steer business to your competitors’ product lines? Legally, what if your soon-to-be-former distribution and sales partners go to lawyers in an attempt to force you to continue those relationships, or, to compensate them for losing access to your lines? What if, heaven forbid, termination of distributors, dealers, or sales representatives brings out claims that you have been engaging in unlawful activity, most commonly alleged to be violations of antitrust laws?

To weigh these risks, manufacturers contemplating distribution changes should first review two basic things: (1) what the contracts they have in place allow and require; and (2) what is mandated by law. Many contracts, and the existing laws in many states, delineate when termination is allowed and on what grounds, how much notice is required, whether inventory must be repurchased, what commissions must be paid to sales representatives upon or after termination, and

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what rights and obligations the parties have regarding post-termination competition. Intellectual property, such as trademarks, confidential information, and trade secrets, may also be protected.

We will elaborate on these topics in future Distribution Issues of *The GPMemorandum*.