LEXOLOGY
Getting The Deal Through

Distribution & Agency

in USA

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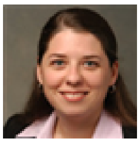

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DIRECT DISTRIBUTION

Ownership structures

May a foreign supplier establish its own entity to import and distribute its products in your jurisdiction?

Generally yes unless the supplier's country, the supplier itself or its principal is the subject of a trade embargo or sanctions. As at December 2019, the countries on the embargo list are the Crimea region of Ukraine, Cuba, Iran, North Korea and Syria. In addition, there are sanctions affecting specified persons and categories of persons relating to the following countries or areas: Afghanistan, the Balkans, Belarus, Burundi, the Central African Republic, the Democratic Republic of the Congo, Iraq, Lebanon, Libya, Mali, Nicaragua, Russia (including some persons in Ukraine and the Crimea region of Ukraine), Somalia, South Sudan, Venezuela, Yemen and Zimbabwe. The lists of embargoed countries and sanctioned individuals and entities are maintained by the Office of Foreign Assets Control (OFAC) of the US Department of Treasury. For details, see the OFAC sanctions page at www.treasury.gov/resource-center/sanctions.

There are also certain industries in which foreign ownership is restricted or regulated, either nationally or by certain states, such as defence contracting, banking and alcoholic beverages.

May a foreign supplier be a partial owner with a local company of the importer of its products?

Generally yes, subject to embargoes, sanctions and certain industries.

What types of business entities are best suited for an importer owned by a foreign supplier? How are they formed? What laws govern them?

Any importer, whether foreign-owned or not, should operate through a form of entity whose liability is limited to the assets of the entity to minimise the risk of the owners' assets being available to satisfy claims for the activities of the business. The most common of these are the corporation and the limited liability company (LLC). These are formed under state law by filing documents with the chosen US state, and that state's laws will govern the entity as to its internal governance and the relationships among the owners and the entity.

While LLCs are generally more flexible with respect to governance, economic structure and corporate formalities, for a foreign parent a corporation will often be preferable from a tax perspective, depending on the applicable tax treaties between the United States and the foreign parent's home jurisdiction, as well as the tax laws of that jurisdiction.

Restrictions

Does your jurisdiction restrict foreign businesses from operating in the jurisdiction, or limit foreign investment in or ownership of domestic business entities?

Generally there are no restrictions, subject to embargoes, sanctions and certain industries. US states generally do require, if an entity is doing business in the state, that it qualify to do business, which involves filing with the state, agreeing to be subject to the jurisdiction of the state and appointing an agent for service of legal process in the state. The definition of doing business varies somewhat by state and is extremely fact-based, but generally includes the operation of a business facility in the state. Typically, a company that fails to qualify when it is required to do so will not be entitled to maintain any action or proceeding in the courts of the state. Of course, there are likely to be tax consequences for a foreign business that operates directly in the United States.

Equity interests

May the foreign supplier own an equity interest in the local entity that distributes its products?

Yes, unless the supplier's country, the supplier itself or the supplier's principal is the subject of a trade embargo or sanctions. The lists of embargoed countries and sanctioned individuals and entities are maintained by the Office of Foreign Assets Control (OFAC) of the US Department of Treasury. For details, see the OFAC sanctions page at www.treasury.gov/resource-center/sanctions.

There are also certain industries in which foreign ownership is restricted or regulated, either nationally or by certain states, such as defence contracting, banking and alcoholic beverages.

Tax considerations

What are the tax considerations for foreign suppliers and for the formation of an importer owned by a foreign supplier? What taxes are applicable to foreign businesses and individuals that operate in your jurisdiction or own interests in local businesses?

Foreign businesses and individuals are generally subject to federal (national US) income tax on their taxable income that is deemed to be 'effectively connected' with a US trade or business (effectively connected income (ECI)) at the normal rates applicable to US persons. Non-US persons must file a US income tax return to report this income and may deduct the expenses of the US business. A foreign corporation that has ECI is subject to an additional 30 per cent US branch profits tax on its after-tax net income. A foreign person is also subject to a 30 per cent US withholding tax on US-source 'fixed or determinable annual or periodic' income, which generally includes dividend income.

If a foreign entity provides services in the US, and those services are performed by employees of the foreign entity, the foreign entity will be engaged in a US business. This means that the foreign entity will have to file a US tax return and report and pay tax on its ECI from those services. Also, if the foreign entity invested in a US operating business directly or through an entity treated as a partnership for US tax purposes, the foreign entity itself would be required to file a US tax return and pay taxes on its share of any ECI generated by the operating business. In addition, on a sale of the partnership interests in such an operating business by the foreign entity, the purchaser would be required to withhold 10 per cent of the amount realised on the sale or exchange by the foreign entity under recently enacted changes to the US tax law.

To alleviate both the implications of having to file a tax return in the US and the payment of the branch profits tax, the foreign entity could establish a US subsidiary corporation to employ the individuals who will perform services in the US or to hold the foreign parent's investment in a US operating business. The US subsidiary would file a US tax return and would be subject to US tax at regular US corporate income tax rates on the income generated by the US business, less its business expenses. If the US subsidiary makes any distributions to the foreign parent during the time that it was operating or holding an investment in a business in the US, the distributions would be subject to a US dividend withholding tax at a rate of 30 per cent (or any lesser rate provided in an applicable income tax treaty between the US and the foreign entity's home country). When the US subsidiary sells its US business or its investment in a US business, the US subsidiary would be subject to US tax on any net gain realised on the sale. However, it could then fully liquidate and distribute the proceeds from its business or its investment to its foreign parent, and that liquidating distribution would not be subject to US withholding taxes. Accordingly, a foreign business or individual can avoid a second level of US tax (ie, branch profits tax or dividend withholding tax) on its US business or its investment in a US business if it makes its investment through a wholly owned US corporation, and the US corporation does not make any distributions to the foreign parent until it fully liquidates.

However, depending on the tax rules of the jurisdiction where the foreign business is located and the structure of the foreign company, it may be preferable to structure the US subsidiary as a US partnership that elects to be treated as a corporation for US tax purposes. This structure will have the same US tax benefits of investment through a US corporation as discussed above and may also allow the investing company or its equity owners to receive a tax credit in its local jurisdiction for the US corporate taxes paid by the US subsidiary. Often income tax treaties between the US and other countries can affect the preferred structure and offer opportunities to reduce the total tax burden from a foreign business's US operations.

LOCAL DISTRIBUTORS AND COMMERCIAL AGENTS

Distribution relationships

What alternative distribution relationships are available to a supplier?

The options for distribution, for the most part, are limited only by the creativity of the business people structuring the relationship. The most common are discussed below.

Direct distribution

Distribution by the foreign supplier using its own employees or through a subsidiary.

Commercial agents and sales representatives

The agent does not purchase or take title to the goods, but rather sells them on behalf of the foreign supplier and receives a commission. Matters such as who actually delivers the product, who generates the invoice, how risk of non-payment is shared and other logistical matters may be addressed by contract, together with a definition of each party's duties and how the relationship may be terminated.

Independent distributors

The supplier contracts with an independent distributor that buys goods from the supplier, taking title to those goods, and resells them at a profit to its own customers. The details of the relationship, including the responsibilities of each side and the parties' rights to terminate, are defined by contract.

Franchising

Franchising, under the typical definition, amounts to the use of independent distributors who: (i) are licensed to use the supplier's trademarks, either in the business name or in the products sold; (ii) are required to follow a prescribed marketing plan or method of operation; and (iii) pay a franchise fee to the supplier. (Under New York law, a franchise exists when either of the first two elements is present, and a franchise fee is paid.) The specific definition and the consequences of being deemed a franchise vary from state to state. In many US states, franchises are regulated in one, or both, of two ways. First, many states and the Federal Trade Commission (FTC) require disclosure documents in a prescribed format to be provided to the prospective franchisee and, in some states, to be registered with the state. Second, some states regulate the substance of the relationship between the franchisor and the franchisee in various ways, most notably by restricting the franchisor's right to terminate or not renew the relationship except for statutorily defined good cause, often requiring a specified period in which the franchisee may cure any default. States that regulate franchising often require franchisors to submit to jurisdiction and appoint an agent for service of process in the franchisee's state.

Joint ventures

A joint venture can be established by a foreign supplier with its distribution partner in the US, whether the partner is an agent, distributor or franchisee, by having the local distribution entity owned in part by the supplier, directly or through a subsidiary, or through another form of sharing of profits and expenses. An ownership interest can provide greater control through ownership rights and representation on a board of directors or management committee.

Licensing of manufacturing rights

A foreign supplier may license a US manufacturer to use its intellectual property – patent, copyright, trademark or trade secrets – to make its products locally and sell them. While all the implications of licensing intellectual property are beyond the scope of this chapter, care must be taken by the licensor to maintain quality control over the finished product and the use of the intellectual property. Failure to do so can not only put the brand equity at risk, but it also risks the loss of trademark protection.

Private label

Distribution of products under a private label amounts to a reverse licensing arrangement where a US distributor or retailer distributes the foreign supplier's products under the US business's own trademark. In essence, the supplier gives up its own brand name in exchange for the distribution strength of its US partner, with the supplier reaping no enhanced brand value. Control over sales, distribution, marketing and advertising are in the hands of the local brand owner, resulting in negligible distribution costs to the supplier and virtually no control, save perhaps for sales and performance benchmarks in the contract, with benefits to the supplier limited to its profits on sales of the product.

Legislation and regulators

What laws and government agencies regulate the relationship between a supplier and its distributor, agent or other representative? Are there industry self-regulatory constraints or other restrictions that may govern the distribution relationship?

By and large, the relationship between the supplier and its distribution partner is governed by contract, which the parties are free to structure as they wish. Notable exceptions are: (i) business franchises, which are regulated by federal disclosure requirements and by various state disclosure, registration and relationship laws; and (ii) federal and state laws governing certain industries, which can regulate the right of a supplier to terminate a distribution relationship, among other aspects of the relationship. There are federal laws governing automobile dealers and petroleum products retailers (petrol stations). Many states have similar laws for those industries, and there are state laws governing beer, wine, and spirits, farm equipment and occasionally other industries. (Understanding the laws and regulations governing businesses and individuals in the US is complicated by the fact that there is regulation at the national, federal and state level by each of the 50 US states, Washington, DC, and US territories and possessions, such as Puerto Rico, the US Virgin Islands and Guam.)

Many industries have adopted codes of conduct applicable to companies in the industry, which suppliers often incorporate into their distribution agreements so they become part of the contract. (Some companies incorporate similar codes of conduct that they have adopted individually.) Such codes of conduct that have been incorporated into contracts by reference are enforceable just like any other contract provision.

Contract termination

Are there any restrictions on a supplier's right to terminate a distribution relationship without cause if permitted by contract? Is any specific cause required to terminate a distribution relationship? Do the answers differ for a decision not to renew the distribution relationship when the contract term expires?

The parties' freedom to contract generally governs the distribution relationship, including the parties' right to terminate or not to renew the relationship without cause or for specified reasons. However, some states' laws restrict the ability of franchisors, and of suppliers in certain industries, to end a relationship. Where a statutory restriction exists, it often prohibits termination without good cause, just cause or a similar formulation. This cause is often narrowly defined and typically does not include poor performance, but often does include a material failure to comply with reasonable contractual requirements, which makes clearly drafted and substantively reasonable contractual performance standards important. Moreover, many states require that, before termination occurs, the franchisee or distributor be given a specified period of time – often 60 or 90 days – in which to cure any deficiency or breach. The statutory 'good cause' requirements typically, but not universally, apply equally to a failure to renew a contract on expiration.

In the absence of such a statute, however, there is generally no restriction on the parties' ability to agree on the conditions for termination with or without cause. Where there is no applicable statute and no agreement, or no contractual provision regarding termination, state law may imply requirements for reasonable notice or a reasonable time to recoup investments made by a distributor before permitting a termination without cause.

Is any mandatory compensation or indemnity required to be paid in the event of a termination without cause or otherwise?

When an applicable statute restricts termination without good cause or where a termination violates a contract's terms, the wrongfully terminated distributor may recover damages and, in some cases, may be able to obtain injunctive relief preventing termination. (The requirements for injunctive relief vary from state to state, but typically require irreparable harm that is not adequately compensable with money damages. This is often interpreted to mean a likely inability for the business to survive in its current form.) Where damages are to be awarded, the amount will vary from state to state and usually is not defined by any specific formula or multiple of profits or sales. Often the damages will be defined as the fair market value of the distributor's business in the terminated product lines (ie, what a willing buyer and a willing seller, neither under compulsion to deal, would agree on for the price of the business). Damages may also be calculated as the net present value of the profits that would be earned by the distributor in the absence of termination. In the absence of an applicable statute or breach of contract, damages will not be assessed for a proper termination.

Transfer of rights or ownership

Will your jurisdiction enforce a distribution contract provision prohibiting or restricting the transfer of the distribution rights to the supplier's products, all or part of the ownership of the distributor or agent, or the distributor or agent's business to a third party?

In general, yes. However, there may be specific laws applicable to certain industries that limit a supplier's ability to prevent transfers of ownership, or otherwise affect the enforceability of such provisions.

REGULATION OF THE DISTRIBUTION RELATIONSHIP

Confidentiality agreements

Are there limitations on the extent to which your jurisdiction will enforce confidentiality provisions in distribution agreements?

Confidentiality agreements are generally enforced as written, subject to normal contract defences, such as fraud or unconscionability, and subject to the obligation to disclose information in legal proceedings and government investigations. US courts have broad disclosure requirements, and the presence of a confidentiality provision will not shield information from discovery if it is material and necessary in the prosecution or defence of an action. While courts disfavour protective orders to maintain the confidentiality of information filed with the court, they can be obtained where necessary to protect competitively valuable information or in other cases where good cause can be shown, particularly where the parties to a litigation can agree. Confidentiality agreements between litigating parties are not unusual as a means of protecting sensitive information provided in discovery.

Information disclosed to government agencies may be subject to public disclosure under federal or state freedom of information laws, although there are exceptions, and protection of sensitive information should be discussed with the government prior to disclosure. It is prudent to include in confidentiality agreements a provision calling for advance notice and cooperation from the party being compelled to disclose, to the extent permitted, prior to making a disclosure required by law, so that the party whose sensitive information may be disclosed can seek appropriate protection.

Confidentiality agreements in the US typically exclude from protection information that the receiving party can demonstrate (i) was already known to the receiving party at the time of disclosure, (ii) became public without fault of the receiving party, (iii) was developed independently by the receiving party without reference to confidential information of the disclosing party, or (iv) was learned by the receiving party from a third party not owing any obligation of confidentiality to the disclosing party. Where the information to be protected is not in fact confidential, as in these situations, a court may not enforce the agreement.

Trade secrets (ie, information that is not generally known and provides a competitive advantage to the owner) will be protected from disclosure or misappropriation where the owner has taken appropriate steps to maintain confidentiality, including obtaining written confidentiality agreements from all employees and others to whom the information is disclosed.

Competing products

Are restrictions on the distribution of competing products in distribution agreements enforceable, either during the term of the relationship or afterwards?

In the absence of market power, a supplier generally is free to restrict a distributor's sales of competing products, although some state laws limit this ability. Where exclusive dealing requirements are so broad as to foreclose a substantial portion of the market, they may be found unlawful as an unreasonable restraint of trade under the antitrust (competition) laws. Restrictions that extend beyond the term of a distribution agreement are disfavoured in some states and generally must be ancillary to the contract and in furtherance of its lawful purposes, as well as reasonable as to the products restricted, the geographical scope of the restriction and the duration. Where a supplier provides a turnkey operation, as in a classic franchise, and discloses all the details of how to operate the business, such post-term restrictions may be more broadly permitted, particularly if they are short in duration and cover a limited geographical area.

Prices

May a supplier control the prices at which its distribution partner resells its products? If not, how are these restrictions enforced?

In general, US antitrust laws, such as section 1 of the Sherman Act, in the absence of monopoly power, address concerted action, not unilateral conduct. Thus, if the supplier itself is making the sale, as is the case with owned outlets, a controlled subsidiary or, in most jurisdictions, through a true agent, the pricing is unilateral and usually not problematic. However, an agreement between independent entities in which the supplier regulates the resale prices of a distributor, franchisee or licensee raises antitrust concerns. Even in the case of a purported unilateral policy (eg, an announced supplier policy to deal only with retailers that maintain the manufacturer's suggested resale price), care must be taken to enforce the policy strictly. Lax enforcement together with ultimate compliance by the customer can be construed as evidence of a resale price maintenance (RPM) agreement rather than mere establishment of a unilateral policy.

In 2007, the US Supreme Court held, in Leegin Creative Leather Products, Inc v PSKS, Inc , that all vertical agreements (ie, agreements between the buyer and seller), even with respect to resale prices, 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 the potential competitive benefits rather than by the per se rule, which makes conduct unlawful without regard to any claimed justifications. In Leegin , the Supreme Court noted a variety of situations in which such RPM may be anticompetitive, and suggested several factors relevant to the rule of reason inquiry, including the number of suppliers using RPM in the industry (the more manufacturers using RPM, the more likely it could facilitate a supplier or dealer cartel), the source of the restraint (if dealers are the impetus for a vertical price restraint, it is more likely to facilitate a dealer cartel or support a dominant, inefficient dealer) and where either the supplier or dealer involved has market power.

Importantly, the states do not always follow federal precedent in enforcing their own antitrust laws and so may not follow Leegin . Indeed, some states have antitrust statutes that explicitly bar RPM programmes. Thus, some state authorities will apply the per se rule to RPM under state law. The result is a patchwork of states accepting or rejecting the Leegin approach in enforcing state antitrust laws. Consequently, before implementing any RPM programme, counsel must carefully examine each relevant state's treatment of RPM, especially as state law continues to develop, review all the facts and determine whether any of the factors described by the Supreme Court in Leegin are present or whether there are other indications that the proposed programme will have anticompetitive effects rather than enhancing interbrand competition.

May a supplier influence resale prices in other ways, such as suggesting resale prices, establishing a minimum advertised price policy, announcing it will not deal with customers who do not follow its pricing policy, or otherwise?

It is lawful in the US for a supplier to suggest resale prices so long as there is no enforcement mechanism and the customer remains truly free to set its own prices. In addition, under the rule announced in 1919 by the US Supreme Court in United States v Colgate & Co , a supplier may establish a unilateral policy against sales below the supplier's stated resale price levels and unilaterally choose not to do business with those that do not follow that policy, because only agreements on resale pricing may be unlawful, at least in the absence of market power. But care must be taken not to take steps that would convert such a unilateral policy into an agreement. When a supplier's actions go beyond mere announcement of a policy, and it employs other means to obtain adherence to its resale prices, an RPM agreement can be created. Colgate policies can be notoriously difficult to administer in practice because salespeople often try to persuade a customer to adhere to the policy instead of simply terminating sales upon a violation (with the resulting loss of sales to the salesperson), and such efforts can be enough to take the seller out of the Colgate safe harbour and into a potentially unlawful RPM situation.

Minimum advertised price (MAP) policies that control the prices a supplier advertises, but not the actual sales price, are also generally permitted, although the issue of what constitutes an advertised price for online sales can have almost metaphysical dimensions. To avoid classification as RPM, the MAP policy must not control the actual resale price but only the advertised price. The closer to the point of sale that advertising is controlled, the greater the risk. Thus, in the bricks-and-mortar world, policies restricting advertising in broadcast and print media are more likely to be permitted; restrictions on in-store signage would be riskier, and restrictions on actual price tags on merchandise most likely would be deemed a restriction on actual, rather than advertised, price. Online, sellers have most often restricted banner ads and the price shown when an item is displayed. Restrictions on the price shown once a consumer places an item in his or her shopping cart carry a greater risk, which explains why some items are displayed with the legend 'Place item in cart for lower price'. Where the supplier does not prohibit an advertised price inconsistent with the supplier's policy, but instead, as part of a cooperative advertising programme, conditions reimbursement of all or a portion of the cost of an advertisement on compliance with a supplier's MAP policy, the risk is reduced, although not eliminated.

May a distribution contract specify that the supplier's price to the distributor will be no higher than its lowest price to other customers?

In general, yes. Most favoured customer clauses are widespread, and courts generally have applied the rule of reason and found that they do not unreasonably restrain trade.

In 2010, however, the US Department of Justice filed an action in federal court in Michigan against health insurer Blue Cross Blue Shield (BCBS), claiming its use of these clauses thwarted competition, in violation of antitrust laws. The Department asserted that, because of its market power, BCBS harmed competition by requiring hospitals to agree to charge other insurers as much as 40 per cent more than they charged BCBS. (The case was voluntarily dismissed by the Department of Justice after the state of Michigan passed a law prohibiting health insurers from using most favoured customer clauses.) In the Apple e-books case, a federal district court found that a most favoured 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 US Court of Appeals for the Second Circuit. Apple sought Supreme Court review; however, the Court declined to review the decision.

The presence of most favoured customer clauses may also lead a supplier to reject an otherwise attractive offer from a customer to take surplus inventory at a lower price, because the discounted price would have to be offered to all customers with a most favoured customer clause. Contract drafters should therefore examine whether a most favoured customer clause raises antitrust risks in the context of their client's particular market share and pricing practices, with particular caution advisable where market power is present.

Are there restrictions on a seller's ability to charge different prices to different customers, based on location, type of customer, quantities purchased, or otherwise?

Yes. The federal Robinson–Patman Act prohibits, with certain exceptions, price differences (as well as discrimination in related services or facilities) in contemporaneous interstate sales of commodities of like grade and quality for use or resale within the US that causes antitrust injury. The basic principle is that big purchasers may not be favoured over small ones. The Robinson–Patman Act also requires promotional programmes to be available to customers on a proportionally equal basis. The Act does not apply to services, leases or export sales.

The statute is often criticised, and is honoured more in the breach than the observance, as quantity discounts are commonplace and government enforcement actions are rare. Private damage actions, however, are still brought with some frequency, although the requirement of showing antitrust injury is often an obstacle to success. To prevail under the statute, a plaintiff must show that the price difference had a reasonable possibility of causing injury to competition or competitors, a standard that has been tightened by recent case law.

There are two principal defences to a Robinson–Patman Act claim. First, showing that the price difference was justified by cost differences is a defence. This defence, however, is notoriously difficult to establish, requiring detailed data as to the cost differences applicable to the different sales at different prices. Second, under the 'meeting competition' defence, prices may be lowered to meet (but not beat) a competitor's price, where there is a good faith basis for believing the competitor actually made a lower offer. If a copy of the competitor's invoice or price quotation cannot be obtained, the company should gather as much information as possible to support the belief that the competitor offered the lower price. The lower price must not, however, be confirmed with the competitor, which could provide evidence supporting a horizontal price-fixing conspiracy by the suppliers. Rather, the supplier should obtain that information through other sources, such as customer documentation or market surveys.

There are also state laws that restrict price discrimination. Some are generally applicable and modelled on the Robinson–Patman Act, but apply to intrastate sales instead of or in addition to interstate sales. Others restrict locality discrimination, charging different prices in different parts of a state. Some states, such as California, have unfair competition laws that prohibit below-cost pricing (which in certain circumstances may also violate federal law) and the provision of secret and unearned rebates to only some competing buyers. Other state laws apply to specific industries, such as motor vehicles or alcoholic beverages, and prohibit discrimination in pricing to dealers.

Geographic and customer restrictions

May a supplier restrict the geographic areas or categories of customers to which its distribution partner resells? Are exclusive territories permitted? Is there a distinction between active sales efforts and passive sales that are not actively solicited, and how are those terms defined?

As a general rule, yes. Non-price vertical restraints are judged by the rule of reason in the United States and are generally permitted, in the absence of market power. 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, thus are governed by the rule of reason. Exclusive territories necessarily reduce intrabrand competition between distributors of the same products. But by eliminating a competing distributor that could 'free-ride' on the promotional and service efforts of another and undercut its price, and thus making it feasible for the remaining distributor to sustain those efforts, exclusive territories can enhance interbrand competition between suppliers of competing products, and so are generally viewed as pro-competitive on balance.

The distinction between active and passive selling applicable in Europe is not generally relevant under US antitrust law. Another distinction from the European approach is that restrictions on online sales are viewed as a non-price vertical restraint and so are judged by the rule of reason and generally permitted, in the absence of market power. Courts have upheld prohibitions on mail order and telephone sales under the rule of reason, and restrictions on internet sales – even an absolute prohibition – should be judged no differently.

However, customer allocation by competitors is a horizontal arrangement rather than a vertical one and is per se illegal. It is thus critical that the impetus for exclusive territories come from the supplier in a vertical arrangement and not from dealers or distributors making a horizontal allocation of territories.

Many US cases apply a 'market power screen' in rule of reason cases, and uphold non-price vertical restraints whenever the defendant lacks market power. These restraints, including exclusive territories, will be viewed more sceptically if market power exists.

If geographic and customer restrictions are prohibited, how is this enforced?

Like most competition laws in the US, the geographic and customer restrictions, to the extent they may violate the law in some circumstances, may be enforced by federal or state antitrust authorities or challenged by a private party claiming to have suffered harm as a result. While horizontal antitrust violations may be the subject of criminal enforcement actions in some circumstances, it would be highly unusual for non-price vertical restraints to be the subject of criminal proceedings.

Online sales

May a supplier restrict or prohibit e-commerce sales by its distribution partners?

Restrictions on online sales are a non-price vertical restraint, judged by the rule of reason and generally permitted, in the absence of market power. Courts have upheld prohibitions on mail order and telephone sales under the rule of reason, and restrictions on internet sales – even an absolute prohibition – should be judged no differently.

May a distributor or agent restrict a supplier's sales through e-commerce intermediaries into the distribution partner's territory? May it require the supplier to obtain reports of such sales by territory and a payment of 'invasion fees' or similar amounts to the distribution partner?

The inherently borderless nature of e-commerce means that e-commerce sales, if permitted or secondarily sourced, may well adversely affect distributors into whose exclusive territories e-commerce sales are made, and may benefit distributors who have distribution centres of e-commerce intermediaries located in their territories from which sales are made to the territories of other distributors. These disproportionate effects may be dealt with in the contract by having the distributor that benefits from out-of-territory sales by an intermediary in its territory pay an 'invasion fee' or similar payment to the distributor into whose territory the sales are made, or by having the supplier make the payment to the infringed distributor. Of course, this requires a determination of the number of 'transferred' sales made by the intermediary. If reporting of those sales can be obtained, then the determination is easy. There is no legal prohibiton on requiring such reports, but not all e-commerce intermediaries may be willing to provide them. In the absence of such reports, some kind of estimate is needed, perhaps based on relative non-e-commerce sales volumes in the territories. Again, the fundamental freedom to contract applies, and such determinations are permitted and becoming more common.

Refusal to deal

Under what circumstances may a supplier refuse to deal with particular customers? May a supplier restrict its distributor's ability to deal with particular customers?

In general, a business that does not have market power is free to choose its customers and do or not do business with whomever it wishes. This can include restricting a distributor's ability to do business with particular customers or classes of customers, a vertical restraint that will be judged by the rule of reason. A supplier with market power will be more limited in its ability to engage in such practices if an adverse effect on competition can be shown. In certain circumstances, courts have found that a monopolist may have an obligation to deal, or to continue dealing, with its competitors.

Note that an agreement among competitors at the same level of distribution not to deal with certain customers, or to restrict with whom customers may deal, will be treated as a horizontal and per se illegal restraint rather than as a vertical restraint governed by the rule of reason. Thus where a restriction on dealing with certain customers originates with a group of competing distributors, a supplier may be at risk of being found to be an illegal participant in that horizontal conspiracy, even though the same restraint originated by the supplier might well be lawful.

There may be some industries in some states where a supplier is required to deal with all customers. For example, in many states, alcoholic beverage wholesalers must sell to all licensed retailers.

Competition concerns

Under what circumstances might a distribution or agency agreement be deemed a reportable transaction under merger control rules and require clearance by the competition authority? What standards would be used to evaluate such a transaction?

Acquisitions of businesses or interests in businesses, including a supplier's purchase of an ownership interest in a distributor, may be subject to filing requirements and federal antitrust agency review if certain thresholds are met as to the size of the transaction (more than US$94 million) and the size of the parties. Regarding the latter, if the value of the proposed transaction is more than US$376 million, it is reportable; however, if the value is more than US$94 million but less than US$376 million, it is reportable if one party to the transaction has total assets or net sales of US$188 million or more and the other has total assets or net sales of US$18.8 million or more. These dollar amounts are adjusted annually for inflation. New dollar thresholds are expected to be announced in the first quarter of 2021. In the absence of an ownership interest, however, distribution relationships are not generally subject to antitrust reporting requirements or agency clearance procedures.

Do your jurisdiction's antitrust or competition laws constrain the relationship between suppliers and their distribution partners in any other ways? How are any such laws enforced and by which agencies? Can private parties bring actions under antitrust or competition laws? What remedies are available?

Vertical agreements between suppliers and distributors are generally governed by the rule of reason, under which the anticompetitive effects of the restraint are weighed against any possible pro-competitive effects, and in the absence of market power, will usually be found lawful. In contrast, horizontal agreements among competitors at the same level of distribution relating to matters such as pricing, allocation of customers or territories, or production levels, are prohibited by the per se rule.

Accordingly, it is important for suppliers and distributors not only to avoid such agreements with their competitors, but also to avoid putting themselves or their distribution partners into a position where they might be deemed participants in a horizontal conspiracy at either distribution partner's level of distribution. Thus, suppliers should not exchange current or future pricing or production information with their competitors, should not use their common distributors to facilitate such information exchanges, should not share one distributor's pricing information with other distributors, and should not agree to territorial allocations made by their distributors rather than imposed by the supplier. Distributors should not share with one supplier pricing or production information received from another. Similarly, suppliers should not share information with each other about their common distributors as such exchanges could support a claim of a concerted refusal to deal should both suppliers then decide to terminate their relationships with the distributor.

Returning to purely vertical relationships, a supplier may not require its customers to purchase one product (the tied product) to be able to purchase another product (the tying product) if the supplier has substantial economic power in the tying product market, and a 'not insubstantial' amount of interstate or international commerce in the tied product is affected. One of the difficult questions in a tying analysis is whether there are in fact two distinct products, one of which is forced on customers who would not otherwise purchase it as a result of market power with respect to the other.

The antitrust laws are enforced both by government action and by private party litigation. At the federal level, both the US Department of Justice and the Federal Trade Commission (FTC) enforce the antitrust laws. They may seek criminal or civil enforcement penalties. Jail terms are not uncommon for antitrust violations, especially horizontal ones.

Maximum fines for each violation are US$1 million for individuals and US$100 million for corporations, subject to being increased to twice the amount gained from the illegal acts or twice the money lost by the victims of the crime if either of those amounts is over US$100 million. In addition, both federal agencies can bring civil actions to enjoin violations of the antitrust laws, disgorge profits, impose structural remedies and recover substantial civil penalties. The federal agencies often cooperate with foreign antitrust and competition authorities in investigating violations.

State attorneys general also actively prosecute antitrust cases and have similar authority to the federal agencies within their own states. State antitrust laws also provide civil and criminal penalties, and the states frequently cooperate with each other and with the federal agencies in multistate investigations and prosecutions.

Last, but certainly not least, private plaintiffs may bring civil actions under the antitrust laws and recover treble damages – that is, three times the actual damages caused by the violation – and attorneys' fees (not the usual rule in the US, where each party generally pays its own legal fees, regardless of who prevails). The exposure in an antitrust action can thus be extremely high, as can the costs of litigation.

Parallel imports

Are there ways in which a distributor or agent can prevent parallel or 'grey market' imports into its territory of the supplier's products?

Importation of goods bearing a registered trademark, even if genuine, can be blocked through the US Customs and Border Protection Service (CBP), provided the non-US manufacturer is not affiliated with the US trademark owner, under the Tariff Act, which prohibits the importation of a product manufactured abroad 'that bears a trademark owned by a citizen of . . . the United States'. The CBP can also block genuine trademarked goods not intended for the US market, even if the non-US manufacturer is affiliated, if the goods are physically and materially different from the goods intended for sale in the US. However, the grey importer can bring in the products if a disclaimer is affixed stating that the goods are materially and physically different from the authorised US goods. In addition, where parallel imported goods are materially different from the US goods in quality, features, warranty or the like, a trademark infringement claim is possible where customer confusion is likely.

There is no current ability to restrict grey market importation under a copyright theory. The Supreme Court held in 2013, in Kirtsaeng v John Wiley & Sons Inc , that a copyright owner cannot exercise control over a copyrighted work after its first sale, even if that first sale occurs outside the US. Moreover, reliance on an insubstantial element of a product protected by copyright to attempt to block parallel imports may be held to be copyright misuse, which prevents enforcement of the copyright.

Until recently, grey market importation of products protected by a US patent infringed the patent even if the products were lawfully sold abroad with the authority of the patent holder. However, in 2017, the Supreme Court held in Impression Prods, Inc v Lexmark Int'l, Inc that an authorised sale abroad of a product protected by a US patent exhausted the patentee's right to prevent importation into the United States. Accordingly, patent law has been changed to conform to copyright law, as discussed above.

Advertising

What restrictions exist on the ability of a supplier or distributor to advertise and market the products it sells? May a supplier pass all or part of its cost of advertising on to its distribution partners or require them to share in its cost of advertising?

Advertising is regulated by both federal and state laws that prohibit false, misleading or deceptive advertising. Where advertising makes statements that could reasonably be interpreted as an objective factual claim (in contrast to statements such as ‘world’s best water’, that are more likely to be regarded as marketing puffery), the advertiser must have reasonable substantiating documentation to support the claim before the advertising is disseminated.

Federally, advertising is regulated principally by the FTC. The FTC has broad authority under the FTC Act to prevent ‘unfair or deceptive acts or practices’ and more specific authority to prohibit misleading claims for food, drugs, devices, services and cosmetics. The FTC can sue in the federal courts, and often will enter into consent orders with defendants in advance of litigation that may incorporate a variety of remedies.

The FTC considers advertising deceptive if it contains misrepresentations or omissions likely to mislead consumers acting reasonably to their detriment. While the FTC must show the deception was material to consumers’ purchasing decisions, it does not have to show actual injury to consumers. Similarly, the FTC deems advertising to be unfair if it causes or is likely to cause substantial consumer injury that is not reasonably avoidable by consumers themselves and is not outweighed by countervailing benefits to consumers or competition.

The most common remedy in advertising cases is an order to enjoin the conduct complained of and prevent future violations. Where such an order is not enough to correct misunderstandings caused by misleading advertising, the FTC may order corrective advertising. In addition, the FTC may seek other consumer redress or disgorgement of profits, and, in the case of violations of prior orders or trade regulation rules, civil penalties.

The states regulate advertising in similar ways under a variety of state unfair competition and unfair trade practice statutes. These are enforced by the state attorneys general in a manner similar to the FTC's enforcement of federal law.

Finally, private parties – often competitors – can bring actions in the state and federal courts to enjoin or seek damages for false or deceptive advertising that causes harm to competitors or consumers.

There are additional restrictions on specific types of advertising. Sweepstakes, in which prizes are awarded by chance to consumers who have made a purchase or provided some other consideration, are regulated by many states, some of which require prior registration. Endorsements are regulated, most notably by the FTC Endorsement Guidelines, which are intended to ensure that statements of third-party endorsers reflect an honest statement of the endorser’s opinion and are substantiated to the same extent as required for the advertiser’s own statements. These Guidelines require, among other things, disclosure of any relationship between the endorser and the supplier of the product, including requiring the supplier to ensure that bloggers who review a product disclose when the supplier provided a free sample for evaluation and that employees who comment on their employer’s products or services on social media or websites disclose that relationship.

Finally, there are specific regulations governing certain claims, such as those asserting health benefits, or claiming ‘green’ products, and many industries have adopted self-regulatory advertising codes that also should be followed.

There are no restrictions on suppliers requiring reimbursement or contributions for advertising costs from distribution partners, or on distribution partners agreeing to share in advertising expenses. Freedom of contract governs, and it is commonplace to include provisions governing the sharing of advertising costs or the contribution from each party to advertising funds to support the products being distributed.

Intellectual property

How may a supplier safeguard its intellectual property from infringement by its distribution partners and by third parties? Are technology transfer agreements common?

Trademarks

Trademarks receive some protection by virtue of use in the US under the federal Lanham Act and under the common law of the states where they are used. The preferable, more effective way to protect trademarks in the US is to obtain trademark registrations through the US Patent and Trademark Office. US trademark registrations can be based on a supplier's home country trademark registration or on use in interstate or foreign commerce in the US. Applications can also be based on an intent to use the trademark in the US, but the registration will not be issued until the supplier has submitted proof of actual use in the US. US federal trademark registration can also be obtained under the Madrid Protocol if the supplier's home country is a signatory to the treaty.

Only the owner of a trademark may obtain a US registration. Accordingly, in general the supplier, not the local distributor, will be the applicant. Contracts typically forbid the distributor from registering the trademark to protect the supplier from infringement by its distribution partner.

Patents

In general, patent protection in the US must be sought in conjunction with patent protection in the supplier's home country. If a US patent application has not been filed within a specified period of time – usually one year – after the home country filing, a US patent will not be available. A longer period may apply under the Patent Cooperation Treaty if the home country is a signatory.

Assuming there is US patent protection, the supplier may enforce the patent through private lawsuits in US courts against infringers. Both injunctive relief and damages are available remedies. Where the infringing goods are imported into the US, an exclusion order from the International Trade Commission may also be sought. While this procedure is faster, no damage remedy is available. Unauthorised sale of patented products by the distribution partner is usually regulated by contract but can also be remedied through an infringement suit.

Copyright

Under the US Copyright Act, the copyright in a work of authorship, including textual, artistic, musical and audiovisual works, is protected from the moment the work is fixed in a tangible medium of expression. Publication with a copyright notice is no longer necessary to retain US copyright protection. However, a supplier's ability to protect its copyrights in the US is significantly enhanced by registration with the US Copyright Office. First, registration is required before a copyright can be enforced in the US courts. Second, where a copyright has been registered before an infringer's activities began, the remedies available for infringement are enhanced: the plaintiff need not prove actual damages from the infringement, but may elect to recover statutory damages in an amount, to be set by the court or jury, of up to US$150,000 per infringed work in the case of wilful infringement. In addition, where the copyright is registered, the plaintiff may recover, at the court's discretion, the costs of the suit, including attorneys' fees.

Trade secrets and know-how

Trade secrets (ie, information that is not generally known and provides a competitive advantage to the owner) will be protected from disclosure or misappropriation where the owner has taken appropriate steps to maintain confidentiality, including obtaining written confidentiality agreements from all employees and others to whom the information is disclosed. Third parties who steal trade secrets (eg, by industrial espionage or hiring of key employees) may be sued for theft of trade secrets under applicable state or federal law. For employees, mere knowledge in a particular field acquired through long experience with one employer is not a protectable trade secret that will prevent a key employee from changing jobs. In such circumstances, non-compete agreements may give suppliers some protection, but there are limits on the time frame and geographical scope.

Technology transfer agreements

Technology transfer agreements are typically used to transfer technology from development organisations, such as universities or government, to commercial organisations for monetisation. They are not commonly used to structure the relationships between commercial suppliers and their distribution partners. In those cases, licence agreements are more common.

Consumer protection

What consumer protection laws are relevant to a supplier or distributor?

There are many federal and state consumer protection laws that are important to suppliers and distributors, well beyond what can be addressed in any detail here. At the federal level, these include a number of laws relating to consumer credit, including the Fair Credit Reporting Act, the Truth in Lending Act, the Fair Credit Billing Act, the Fair Debt Collection Practices Act, the Identity Theft and Assumption Deterrence Act of 1998 and the Credit Accountability, Responsibility, and Disclosure Act. Other federal consumer protection laws and regulations include the CAN-SPAM Act (regulating the use of unsolicited commercial email), the FTC Used Car Rule, the FTC Mail or Telephone Order Merchandise Rule (which covers internet and fax sales as well as telephone and mail order sales and regulates shipment times and related statements and cancellation rights), the FTC Telemarketing Sales Rule under the Telemarketing and Consumer Fraud and Abuse Prevention Act, and various labelling and packaging requirements for food and beverages, textiles and wool, appliances, alcoholic beverages and other industries. To gain a sense of the range of regulations and to review FTC guidance on the subject, visit the FTC website at www.business.ftc.gov.

In addition, most states have very broad consumer protection laws governing unfair or deceptive trade practices and specific laws governing industries such as mobile homes, health clubs, household storage, gasoline stations and others. Often these provide a consumer right, within a defined period, to rescind contracts made in certain circumstances. For example, in New York, there is a 72-hour right to cancel for door-to-door sales, dating services, health clubs and home improvement contracts. Contracts for such transactions must clearly state the right to cancel.

Product recalls

Briefly describe any legal requirements regarding recalls of distributed products. May the distribution agreement delineate which party is responsible for carrying out and bearing the cost of a recall?

Recalls of products are regulated by a number of federal and state agencies, including the Food and Drug Administration, the US Department of Agriculture and the Consumer Product Safety Commission. In addition, manufacturers, importers and distributors often initiate voluntary recalls to remove a defective or dangerous product from the marketplace before it can cause harm, to avoid the potential liability and reputational harm that can come from damage, injuries or deaths.

It is prudent to define in the distribution contract the parties' respective responsibilities in the event of a recall, including who may decide to initiate a recall, how it will be implemented and who will pay the costs, including credits that direct and indirect customers may require for recalled products.

Warranties

To what extent may a supplier limit the warranties it provides to its distribution partners and to what extent can both limit the warranties provided to their downstream customers?

There are both federal and state laws regulating warranties. The main federal law is the Magnuson–Moss Warranty Act, which applies to consumer products with a written warranty. While there is no requirement that a warranty be offered, if a written warranty is provided, then the Act requires certain disclosure of warranty terms, imposes certain requirements, and mandates certain remedies for consumers.

The Act and the FTC Rules promulgated under it require that a written warranty be stated to be either ‘full’ or ‘limited’ for any consumer product that costs more than US$10, and imposes disclosure requirements for products costing more than US$15. Specified information about the coverage of the warranty must be set forth in a single document in simple, readily understood language, and the warranties must be available where the products are sold so that consumers can read them before deciding to purchase.

A warranty is ‘full’ only if:

- it does not limit the duration of implied warranties;
- warranty service is provided to anyone who owns the product during the warranty period, not just the first purchaser;
- warranty service is provided free, including costs of returning, removing and reinstalling the product;
- the consumer may choose either a replacement or a full refund if the product cannot be repaired after a reasonable number of attempts; and
- consumers are not required to do anything as a condition to obtain warranty service (including returning a warranty card), other than to give notice that the product needs service, unless the requirement is reasonable.

If any of the above conditions is not met, then the warranty is 'limited' rather than 'full'.

The FTC requires disclosure of certain elements in every warranty, including precisely what is and is not covered by the warranty, when the warranty begins and ends, how covered problems will be resolved and, if necessary for clarity, what will not be done or covered (eg, shipping, removal or reinstallation costs, consequential damage caused by a defect, incidental costs incurred), and a statement that the warranty ‘gives you specific legal rights, and you may also have other rights which vary from state to state’. Any additional requirements or restrictions, such as acts that will void the warranty, must be disclosed.

The Magnuson–Moss Act prohibits a written warranty from disclaiming or modifying any warranties that are implied under applicable law, although a limited warranty may limit the duration of implied warranties to the duration of the limited warranty, subject to contrary state law.

A written warranty cannot be conditioned on the consumer product being used only with specific other products or services, such as particular accessories, but it may provide that it is voided by the use of inappropriate replacement parts or improper repairs or maintenance. A waiver can be obtained from the FTC if it can be shown that a product will not work properly unless specified parts, accessories or service are used.

The FTC, the US Department of Justice and consumers can sue to enforce the Act, and consumers can recover their court costs and reasonable attorneys’ fees if successful. The Act also encourages businesses to establish informal dispute resolution procedures to settle warranty disputes. Such procedures must meet certain requirements and must not be binding on the consumer.

In addition, other federal laws and regulations govern topics such as warranties for consumer leases, used cars and emissions control systems, as well as advertising of warranties.

In almost all states, warranties are governed by the Uniform Commercial Code, which provides for an express warranty, an implied warranty of merchantability and an implied warranty of fitness for a particular purpose. The implied warranty of merchantability is an implied promise, whenever the product is sold by a merchant, that the goods will function properly for the ordinary purposes for which they are used, would pass without objection in the trade, are adequately packaged and labelled, and conform to any promises made in labelling or packaging. The implied warranty of fitness for a particular use exists only when the seller has reason to know the purpose for which the buyer intends to use the product at the time it is sold, and the buyer relies on the greater knowledge and recommendation of the seller in selecting the product.

The extent to which implied warranties may be disclaimed varies by state. Where permitted, disclaimers usually must be conspicuous, usually interpreted as boldface capital letters. Similarly, state law may permit sellers to limit the damages and other remedies available in case of a breach of warranty. Notice of such disclaimers also generally must be conspicuous.

Many states also have specific 'lemon laws' governing motor vehicles.

Data transfers

Are there restrictions on the exchange of information between a supplier and its distribution partners about the customers and end users of their products? Who owns such information and what data protection or privacy regulations are applicable?

In contrast to many other countries, federal privacy regulation in the United States is limited to a few specific areas, such as children's information, healthcare, financial services and telecommunications. The primary federal regulatory focus is on matters such as transparency to the consumer with respect to the manner in which information will be used and shared and the reasonableness of the data security protections in place. The FTC and other federal agencies have adopted rules in these areas, generally requiring notice to consumers about the collection and use of information; consumer choice with respect to the use and dissemination of information collected from or about them; consumer access to information about them; and appropriate steps to maintain the security and integrity of any information collected. The FTC and state regulatory authorities have also been active in regulating behavioural advertising, mobile apps and information security, and businesses gathering customer information should familiarise themselves with the FTC's guidance in these areas.

Until 2015, companies in the US could subscribe to the Safe Harbour principles agreed to between the FTC and the EU, thereby bridging the gap between EU privacy principles and those of the US, and permitting EU businesses to exchange personal data with their US affiliates and business partners, including distribution partners. The October 2015 decision of the European Court of Justice in the Schrems case invalidated the Safe Harbour arrangement and called into question the ability to share data between the EU and the US in the absence of binding corporate rules, standard contract clauses or some other permitted undertaking of compliance with EU data protection rules. Negotiations to replace the Safe Harbour regime led to a replacement arrangement adopted in 2016 called the EU–US Privacy Shield, which imposes more robust and detailed data protection obligations on US companies that subscribe, including annual self-certification to their compliance with the principles of the Privacy Shield. The Privacy Shield offers EU citizens several routes to redress: complaints to the company must be resolved within 45 days; a no-cost alternative dispute resolution mechanism must be available; and complaints may be made to local European data protection authorities, which will then work with the US Department of Commerce or the FTC to make sure that complaints are investigated and resolved.

In 2019, the Court of Justice of the European Union held hearings to determine whether the Privacy Shield was adequately protecting EU citizens' rights. Pending the court's decision, the future viability of the Privacy Shield remains in doubt, and a provision for annual review of the effectiveness of the Privacy Shield calls into question the extent to which US companies may rely on it. As an alternative to the Privacy Shield, parties to EU–US distribution relationships may rely on binding corporate rules (which are expressly permitted under the EU's General Data Protection Regulation (GDPR)) or on standard contractual clauses that have been approved by the European Commission (which remain a permitted mechanism to transfer personal data outside the European Union, at least for now).

In general, companies collecting information about consumers must say what they will do with the collected information, and do what they say. Within that construct, and subject to the specifically regulated areas, suppliers may exchange customer information with their distribution partners freely, so long as adequate notice of that information exchange has been provided to consumers.

Beyond federal law, all US states and most US territories have also adopted legislation governing consumer information, with data breach legislation imposing notification obligations and remedial action in the event of a security breach being the most common. These state requirements sometimes conflict, which can create compliance problems. A number of states impose specific security obligations on businesses that collect consumer information. For example, the California Consumer Privacy Act of 2018 is a comprehensive data privacy law that will impact businesses around the world that obtain, use, store or otherwise process the personal information of California residents (including California residents who are temporarily located in other places). Among other things, this law would provide California residents the right to know what personal information is being collected about them, the right to know whether their personal information is sold or disclosed and to whom, and the right to say no to the sale of personal information. This law became effective on 1 January 2020.

In addition, the GDPR, which took effect in May 2018, applies to parties in the United States that (i) offer goods or services (even for free) to individuals in the European Economic Area and (ii) process personal data of individuals in the European Economic Area in connection with that activity. The GDPR’s definition of 'personal data' is very expansive, and provides that a wide range of personal identifiers (eg, IP addresses) constitutes personal data. The GDPR gives individuals in the EU greater control over their personal data and imposes many obligations on organisations that collect, handle and otherwise process personal data. It also gives national data protection authorities the power to impose significant fines on organisations that fail to comply.

Parties should clearly define in their distribution contract who controls the customer information that has been collected (ie, who has the right to determine the purposes and means of processing of that information), who has access to it, and the applicable confidentiality obligations (which must conform to the parties’ respective stated privacy policies, which in turn must be consistent with each other). In the absence of such a definition, customer data is likely to belong to the party that collected it, but the sharing of such information without a statement of the recipient’s obligations may result in the recipient’s ability to do as it wishes with the information. Suppliers and their distribution partners should also cooperate in planning to prevent security breaches and to respond to them in accordance with applicable law when they occur.

What requirements apply to suppliers and their distribution partners with respect to protecting the security of customer data they hold?

Many US states require businesses that own, license or maintain personal information about the residents of their states to implement and maintain 'reasonable security procedures and practices', and to protect personal information from unauthorised access, destruction, use, modification or disclosure. However, many of those laws and regulations do not specify what exactly constitutes reasonable security procedures.

Other states are more specific in their requirements. For example, the states of New York and Massachusetts both require businesses that own or license the personal information of the state’s residents to develop, implement and maintain comprehensive written information security programs that contain specific administrative, technical and physical safeguards for the protection of personal information. Under New York State's Stop Hacks and Improve Electronic Data Security Act, businesses that own or license computerised data that includes private information of the state's residents must implement a data security programme that includes the following elements:

- administrative safeguards in which the business:
  - designates one or more employees to coordinate the security programme;
  - identifies reasonably foreseeable internal and external risks;
  - assesses the sufficiency of the safeguards in place to control the identified risks;
  - trains and manages employees in the security programme practices and procedures;
  - selects service providers capable of maintaining appropriate safeguards and requires those safeguards by

    - contract; and
  - adjusts the security programme in light of business changes or new circumstances;
- technical safeguards in which the business:
  - assesses risks in network and software design;
  - assesses risks in information processing, transmission and storage;
  - detects, prevents and responds to attacks or system failures; and
  - regularly tests and monitors the effectiveness of key controls, systems and procedures; and
- physical safeguards in which the business:
  - assesses risks of information storage and disposal;
  - detects, prevents and responds to intrusions;
  - protects against unauthorised access to or use of private information during or after the collection, transportation and disposal of the information; and
  - disposes of private information within a reasonable amount of time after it is no longer needed for business purposes by erasing electronic media so that the information cannot be read or reconstructed.

In addition to statutory and regulatory requirements, parties may contractually agree with each other to maintain security measures that are specified in that contract. If one party fails to abide by its commitments in the contract, it may be liable to the other party for breach of contract.

Employment issues

May a supplier approve or reject the individuals who manage the distribution partner's business, or terminate the relationship if not satisfied with the management?

Under the general principle of freedom of contract, the parties generally may provide as they wish with respect to supplier control over the persons who manage the distributor. Thus, the contract can grant authority to a supplier to approve or reject the individuals who manage the distribution partner's business generally, or the distribution of the supplier's products specifically, for any lawful reason, as well as to terminate the agreement if not satisfied. This general principle is subject to specific franchise or industry regulation. Particularly for alcoholic beverages, many states have laws designed to protect the independence of wholesale distributors; in such states, provisions giving suppliers control over distributor management may be problematic and unenforceable. Where termination is limited to statutorily defined good cause, a right to terminate for dissatisfaction with management may be unenforceable.

Are there circumstances under which a distributor or agent, or its employees, would be treated as an employee of the supplier, and what are the consequences of such treatment? How can a supplier protect against responsibility for potential violations of labour and employment laws by its distribution partners?

There is a risk that distributors – especially single-employee companies or sole proprietorships – may be deemed employees of the supplier. To prevent this, it is in the supplier's interest to ensure an independent contractor relationship between itself and the distributor.

Some states, such as California, have passed or are in the process of adopting legislation establishing a presumption that individuals performing services are employees and outlining baseline factors that must be satisfied for an individual to be considered an independent contractor.

The tests for distinguishing bona fide independent contractors from employees vary from state to state, agency to agency and statute to statute, but generally weigh various factors, including the questions listed below.

- Does the distributor perform similar work for other clients and market similar services to the general public, or does it work exclusively for the supplier?
- Has the distributor made substantial investments in its own vehicles or other equipment or does the distributor rely on equipment of the supplier?
- Does the distributor hire its own employees to perform services for the supplier?
- Does the distributor control its schedule and how it accomplishes its work or is it subject to the supplier's instructions?
- Is the parties' relationship limited in duration or open-ended?
- Does the distributor have substantial skills, experience and training, or is supplier training required?
- Are the distributor's services similar to those of the supplier's employees?
- Does the distributor earn a profit or risk a loss on resales or receive a sales commission or other compensation for its results, or is it compensated for its time (eg, on an hourly or salary basis)?
- Does the distributor receive employee-type benefits from the supplier (eg, paid time off and health insurance)?

No single factor is dispositive; the determination is made on the totality of circumstances based on the facts of each case. The distribution agreement, while not dispositive, should state the parties' intent.

Misclassification may result in substantial employment and tax liabilities for the supplier, including retroactive pay and benefits, other damages and substantial fines and penalties. Employees are generally entitled, among other benefits, to minimum wage and overtime compensation, discrimination and workplace safety protections, unemployment benefits, workers' compensation and disability insurance, protected family, medical and military leaves of absence, and a right to participate in the employer's retirement and health plans and other benefits. While there are federal employee rights, specific benefits vary from state to state.

There is also a risk that a supplier could be deemed a joint employer of an individual employed by a distributor, rendering the supplier liable for compliance with statutory obligations to the employee, such as minimum wage or overtime, paid sick leave, other employee benefits and protection against harassment. Factors looked at to determine whether a supplier is the joint employer of a distributor's employee include (i) whether the supplier regularly controls the employee's schedule or workload, benefits from the individual's services, supervises the employee, or has any overlapping owners, officers or managers with the distributor, and (ii) whether the employee is economically dependent on both the supplier and the distributor (eg, whether the supplier has the power to hire, fire or discipline the employee, or to change any of the employee's terms of employment), and how long the distributor's employee has performed the services for the benefit of the supplier.

Suppliers should engage experienced employment counsel to analyse the relevant facts and determine the proper classification of individuals as either employees or independent contractors, as well as to advise on best practices to avoid a joint employer relationship being established with the distributor's employees being established.

Commission payments

Is the payment of commission to a commercial agent regulated?

About half the US states have laws regulating commission sales representatives. These laws typically require written agreements setting forth how commission is calculated and require payment within a specified period after termination. Some laws provide for double or treble damages for violations. A few, such as Puerto Rico and Minnesota, restrict a supplier's right to terminate a sales representative without statutory good or just cause. In some states, sales representatives may also be protected by franchise laws in certain circumstances.

Good faith and fair dealing

What good faith and fair dealing requirements apply to distribution relationships?

A covenant of good faith and fair dealing is implied by the laws of most states in all commercial contracts, including distribution agreements. This requires the parties to deal with each other in good faith, but generally does not supersede express contractual provisions. Thus, a complaint that a supplier terminated a distribution contract in bad faith, in violation of the covenant of good faith and fair dealing, will generally not succeed in the face of a contractual provision allowing the supplier to terminate without cause. Indeed, cases in a number of states hold that a claim cannot be based solely on a breach of the implied covenant of good faith without some breach of an express provision as well.

In contrast, other courts have found a violation of the implied covenant of good faith where suppliers have acted to the disadvantage of their dealers, notwithstanding an express provision permitting the conduct at issue. For example, a federal district court found that sales by the Carvel ice cream company to supermarkets might violate its duty of good faith to its franchisees, notwithstanding its contractually reserved right, in its 'sole and absolute discretion', to sell in the franchisees' territory via the same or different distribution channels.

Similarly, some courts have found a violation of the implied covenant of good faith where the manner in which a supplier exercised its contractual rights demonstrated bad faith, such as disparagement of the distributor or misappropriation of confidential customer information in connection with an otherwise permitted termination.

Moreover, some specific industry laws impose an explicit obligation of good faith on suppliers and distributors that may be independently enforceable.

Registration of agreements

Are there laws requiring that distribution agreements or intellectual property licence agreements be registered with or approved by any government agency?

With the exception of those state franchise laws that require registration of disclosure documents and some state laws governing specific industries, such as alcoholic beverages, there generally are no such requirements.

Anti-corruption rules

To what extent are anti-bribery or anti-corruption laws applicable to relationships between suppliers and their distribution partners?

It is important that counsel for multinational businesses recognise the risks to a supplier of third-party misconduct by foreign distributors and agents under the Foreign Corrupt Practices Act (FCPA). The FCPA, a criminal statute, prohibits bribery of foreign officials, political parties and candidates for public office. Under the FCPA, a company or individual can be held directly responsible for bribes paid by a third party if the company or individual has knowledge of the third party's misconduct. For example, the FCPA prohibits the giving of anything of value to 'any person' while knowing that all or a portion of the money or thing will be given, 'directly or indirectly', to bribe any foreign official, foreign political party or official, or any candidate for foreign political office. Moreover, constructive knowledge of the misconduct, including wilful blindness or deliberate ignorance, is enough to impose liability. A defendant may be convicted under the FCPA based upon the defendant's 'conscious avoidance' of learning about a third party's illegal business practices. Accordingly, it is critically important to take steps to prevent such misconduct by those acting on a business's behalf, including distributors, agents, brokers, sales representatives, consultants, advisers and other local business partners. A business with foreign business partners must exercise appropriate due diligence in selecting its partners and adequately supervise their activities. It is important to consider FCPA compliance (i) before entering into an agreement with a foreign partner through due diligence, (ii) in the agreement through provisions requiring FCPA compliance and reporting, and (iii) after entering into the agreement through ongoing training, monitoring and audits.

Prohibited and mandatory contractual provisions

Are there any other restrictions on provisions in distribution contracts or limitations on their enforceability? Are there any mandatory provisions? Are there any provisions that local law will deem included even if absent?

Except for specific industry regulation, franchises and antitrust restrictions, the parties are generally free to structure their relationship as they wish. Of course, distribution contracts are subject to the usual contract enforceability defences, such as fraud, unconscionability and lack of consideration, among others. There are certain warranties and a covenant of good faith and fair dealing that are implied by law. Laws governing specific industries and franchises may impute or require other provisions.

In addition, if the contract gives a supplier effective control over the distributor's operations, it may be held vicariously liable to third parties for the distributor's negligence or other misconduct. Similarly, a supplier may be liable for conduct of a distributor if the conduct is required by the supplier or the distributor is represented to third parties as being part of the supplier's operations.

GOVERNING LAW AND CHOICE OF FORUM

Choice of law

Are there restrictions on the parties' contractual choice of a country's law to govern a distribution contract?

A choice of law provision in the distribution contract selecting the law of a specific state or country may be enforced if the jurisdiction chosen bears a reasonable relationship to the transaction (eg, the supplier's or distributor's home jurisdiction). Such contractual choice of law provisions, though generally enforced, are sometimes disregarded by courts in deference to the public policy of states with business franchise or protective industry laws, or because the validity of the contract containing the clause was questioned. Courts have also refused to enforce choice of law provisions that bear no reasonable relation to the parties or contract.

Selecting a particular state's law may result in the application of either a more or less restrictive state franchise law than might otherwise be the case.

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

Unless the parties explicitly disclaim its applicability, the United Nations Convention on Contracts for the International Sales of Goods will govern contracts for sales of goods between parties that have their places of business in different contracting states, of which the US is one.

Choice of forum

Are there restrictions on the parties' contractual choice of courts or arbitration tribunals, whether within or outside your jurisdiction, to resolve contractual disputes?

The parties can provide in the distribution contract for all litigation to be brought in a court located in a particular state or country and can waive their right to seek a transfer. These clauses are sometimes enforced and sometimes not. The Supreme Court, in Burger King Corp v Rudzewicz, has held that a franchisor can constitutionally enforce a forum-selection clause against its franchisees in an action commenced by the franchisor in its home state. Courts in the distributor's home state, however, may refuse to enforce a forum-selection clause on the ground that the public policy interests of the distributor's state outweigh the parties' choice. State franchise laws may expressly prohibit the choice of another state as a forum. 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 factors normally weighed in a transfer motion, at least where the choice is between two federal districts.

A showing of state policy sufficient to outweigh a forum clause may be difficult to make. For example, Maryland courts have held that a forum selection clause favouring 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, and a federal district court in New York upheld a one-sided forum clause that restricted venue in actions by a franchisee, but not in actions by the franchisor. In contrast, the District of Puerto Rico declined to transfer a dispute to California courts as required by a contractual forum clause, as Puerto Rico was more convenient for witnesses, and there was no evidence justifying transfer other than the contract clause.

Arbitration clauses specifying a particular forum are likely to be enforced under the Federal Arbitration Act. The Seventh Circuit US Court of Appeals reversed a district court decision and ordered arbitration in Poland pursuant to contract in a case under the Illinois Beer Industry Fair Dealing Act, holding that the state's public policy expressed in that statute required Illinois law to apply notwithstanding the contract's choice of Polish law, but that this public policy could not overcome the Federal Arbitration Act policy in favour of arbitration.

Litigation

What courts, procedures and remedies are available to suppliers and distribution partners to resolve disputes? Are foreign businesses restricted in their ability to make use of these courts and procedures? Can they expect fair treatment? To what extent can a litigant require disclosure of documents or testimony from an adverse party? What are the advantages and disadvantages to a foreign business of resolving disputes in your country's courts?

Suppliers and their distribution partners have access to both state and federal courts to resolve their disputes, although a company that fails to file its qualification to do business in a state in which it meets the definition of 'doing business' usually will not be entitled to maintain any action or proceeding in the courts of the state. This rule applies to both US companies formed in other states and non-US companies, and in general foreign businesses have equal access to the courts. By and large, foreign companies can expect fair treatment in US courts, especially in the federal courts and courts of the larger commercial states. Some states, such as New York, have a well-established body of commercial law and have created specialised commercial courts with judges experienced in commercial disputes, making these courts a desirable forum for dispute resolution.

Discovery in US courts is very broad, typically requiring disclosure of documents and electronic materials, responses to written interrogatories and deposition testimony of witnesses whenever material and necessary in the prosecution or defence of an action. This substantially increases the cost of litigation in US courts. In response, subject to showing a need for greater discovery, some courts have enacted rules that place limits on the length of depositions, the number of witnesses that may be deposed and the number of interrogatories that may be propounded. Electronic discovery of documents and email is also generally quite broad and can be a significant cost, although some courts may shift that cost to the party seeking the discovery in certain circumstances. In addition, federal and state courts have implemented rules to permit parties to seek to limit discovery so that it is proportionate to the value of the material sought and the value of the case.

Certain industry regulations and industry self-regulatory codes may provide or require certain disputes, such as a claim of wrongful termination, to be resolved before government agencies or industry boards.

Alternative dispute resolution

Will an agreement to mediate or arbitrate disputes be enforced in your jurisdiction? Are there any limitations on the terms of an agreement to arbitrate? What are the advantages and disadvantages for a foreign business of resolving disputes by arbitration in a dispute with a business partner in your country?

A provision for binding arbitration of disputes in place of the courts will generally be enforced under the Federal Arbitration Act (FAA), which favours arbitration agreements, even in the face of state law to the contrary. However, that where state law requires – as some state business franchise laws do – a disclosure that a choice of law or choice of forum provision, including an arbitration clause, may not be enforceable in that state, a question arises as to whether the parties really agreed to the provision. The Ninth Circuit US Court of Appeals has held that a contractual choice of forum for arbitration was unenforceable because of such a mandated disclaimer, finding that the franchisee had no reasonable expectation that it had agreed to arbitrate out-of-state.

Provisions limiting the relief arbitrators may award to actual compensatory damages, or expressly precluding punitive damages, injunctive relief or specific performance, will also generally be enforceable. The US Supreme Court has held that the FAA's central purpose 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. Similarly, courts generally will also enforce a provision for a particular arbitration forum.

However, care should be taken in drafting arbitration clauses not to overreach, because even under the FAA, arbitration agreements may be set aside on the same grounds as any other contract, such as fraud or unconscionability. 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. A district court in California rejected an arbitration clause as unconscionable where the arbitration clause blocked class adjudication (requiring each case to be resolved individually) and proved unfavourable for plaintiffs on a cost-benefit analysis. It is thus prudent to adopt a more balanced approach in drafting arbitration provisions.

Arbitration is private, in contrast to the courts, and, depending on the court, can sometimes be faster and cheaper. It may afford less discovery and can present problems requiring testimony of non-parties, to the disadvantage of a party who needs them. There is generally no appeal from a legally incorrect or factually unfounded decision and arbitrators often seek a compromise result.

While there is no similar statutory underpinning for provisions requiring non-binding mediation before parties may proceed to court or binding arbitration, such a provision generally will be enforced under principles of freedom of contract.

UPDATE AND TRENDS

Key developments

Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? Are there any other current developments or trends that should be noted?

A clear legislative trend in the US is the adoption by states of laws governing data privacy and security. All 50 states have now adopted breach notification laws. States are now beginning to adopt broader consumer privacy laws, such as the California Consumer Privacy Act, the Nevada Privacy of Information Collected on the Internet from Consumers Act and Maine's Act to Protect the Privacy of Online Customer Information. Security of consumer data is also becoming regulated by state laws, such as the New York Stop Hacks and Improve Electronic Data Security Act (SHIELD Act) and Massachusetts's amendments to its data breach law addressing data security programmes.

The result is a patchwork of differing and sometimes inconsistent state laws regulating data privacy, breach and security programs, creating a compliance morass for businesses doing business nationally. Though industry is beginning to support federal legislation to provide uniformity in these areas (beyond the existing legislation governing healthcare, financial services, telecommunications and data gathered from children) and efforts to develop such federal legislation have begun, the prospects for imminent enactment of the legislation are poor. Thus, states can be expected to continue to legislate individually, and the compliance challenges of dealing with the maze of state laws will only grow in the near term.

LAW STATED DATE

Correct as of

Give the date on which the information above is accurate.

7 February 2020