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## Trends in international distribution agreements: USA and the Netherlands

In our present age of globalization, where the cross-border sale of goods is an activity engaged in by all size of business enterprise and not just the large multinational, the distribution contract has become an ever increasingly used legal avenue for getting products to market. Often confronted with the tension between a desire to protect locals who distribute goods on behalf of foreign suppliers from abuse and the necessity of ensuring the free flow of commerce, jurisdictions are required to strike an appropriate balance in regulating such activity. This article discusses some trends in the law applied to distributors of goods within two jurisdictions heavily involved in shaping the global economy, the United States and the Netherlands.

### DEVELOPMENTS IN THE UNITED STATES

European lawyers sometimes overlook that the United States is made up of fifty separate legal jurisdictions, each having laws governing the commercial activities that take place within their borders.<sup>1</sup> While there are federal laws which apply in all fifty states and to some degree a level of harmonization between the jurisdictions, the law of contract is applied by the individual states themselves according to their own internal legislation and case law.

In terms of doing business, the largest and most influential jurisdiction in the United States is California (the next largest being New York at only 60% the size). California's economy accounts for 13% of United States' national output, and has in the past ranked within the top six economies in the world, placing it ahead of France.<sup>2</sup> The gross state product (equivalent to GNP) of California in 2004 was US Dollars 1.5 trillion including USD 19 billion worth of exports to Europe, indicating a strong commercial relationship between the EU and California.<sup>3</sup>

The economic vitality of California therefore contributes to the importance of its laws governing the sale and distribution of goods. For most international lawyers who have a certain familiarity with 'American' law, there exists the common belief that contract law within the US rests squarely on the principle of freedom of contract, meaning that there is little in the way of mandatory law affecting or restricting the parties' choice of terms within their agreement. Certainly, American attitudes toward commercial contracting stand in contrast to European views on certain types of commercial relationships such as agency, where mandatory law often protects the weaker party in a commer-

cial relationship more so than in the US. This generalization, however, is increasingly inaccurate, as there is a growing trend in the United States to provide mandatory legal protection for distributors of certain goods. Indicative of this trend is legislation which has been enacted in California for some time, but is being implemented in similar form among many of the fifty US states.

In 1992 the state legislature of California passed the California Equipment Dealers Act ('CEDA') which is designed to regulate the relationship between distributors and suppliers of agricultural and other types of equipment.<sup>4</sup> The impact of CEDA on the cross-border sale of goods which touch upon California has raised questions about the effect this legislation will have on both out-of-state manufacturers, and distributors alike. This article focuses on certain aspects of CEDA as a model for the types of laws being enacted in the various US states, and examines the impact of this type of legislation on the distribution of goods in comparison to Dutch approaches to the same subject.

### INTRODUCTION TO CEDA

CEDA is an industry sector specific piece of legislation intended to regulate supplier-dealer relationships concerning equipment 'designed for or adapted and used

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1. In addition to the fifty States, the District of Columbia also constitutes a 51<sup>st</sup> (federal) jurisdiction.  
 2. See Cal Facts 2004, available at <[http://www.lao.ca.gov/2004/cal\\_facts/2004\\_calfacts\\_econ.html](http://www.lao.ca.gov/2004/cal_facts/2004_calfacts_econ.html)>.  
 3. See id.  
 4. CAL.PRO.BUS.CODE § 22 900 – 22 927.

for agriculture, livestock, grazing, light industrial and utility equipment'.<sup>5</sup> CEDA is not intended to cover the distribution of goods that do not meet this definition, such as consumer electronic goods, and thus offers no extra protection to distributors who fall outside its scope. Even though the intended target of CEDA is a narrow industry sector, as is explained below, there is still considerable uncertainty as to when it should be applied.

The text of CEDA uses the term 'equipment dealer' which means any person, partnership, corporation, association, or other form of business enterprise, primarily engaged in the retail sale of industry and agricultural equipment.<sup>6</sup> It is important to note that CEDA deals with the retail purchase and sale of equipment, hence the lowest rung of the vertical supply chain, and moreover, by virtue of its broad language covers distributors, franchisees and other types of merchants who are selling the equipment to the public.<sup>7</sup> For the purpose of this article, CEDA will only be dealt with as it pertains to distribution agreements, but it is important not to lose sight of its impact on other types of commercial resale agreements.

The kind of agreement that CEDA applies to is broadly described as 'an oral or written contract or agreement of definite or indefinite duration between a supplier and equipment dealer which provides for the rights and obligations of the parties with respect to the purchase or sale of equipment'.<sup>8</sup> This definition ensures that CEDA cannot be applied to an agency or other sales promotion relationships, since they do not deal with the purchase or sale of goods between the two parties, but rather the commission owed to agents for sales procured by them.

### IMPORTANT PROVISIONS OF CEDA

The most important aspect of CEDA, and other states' laws similar to it, is that it prohibits suppliers from terminating distributors unless such termination is for 'cause'.<sup>9</sup> The wording of this provision is fairly wide

and inclusive so that it goes beyond strictly a situation of termination and restrains a supplier so that it cannot, 'cancel or fail to renew a dealer agreement or substantially change the competitive circumstance of the dealer agreement without cause'.<sup>10</sup>

This is a radical departure from general principles of contract law which normally govern such relationships in the US and specifically California. Most American states, including California, have adopted the Uniform Commercial Code (UCC) Article 2 of which governs the sale of goods.<sup>11</sup> While the UCC contains a general duty to act in good faith, it does not impose specific termination conditions (Although, similar to the CISG, it does provide certain conditions with respect to curing performance defects in the context of delivering goods.), nor act to protect or distinguish distributors from other purchasers who are sometimes regarded in European legal regimes as the weaker party.<sup>12</sup> Theoretically, parties to a distribution agreement would usually be free to negotiate any termination provisions they find reasonable.<sup>13</sup> CEDA, however, by imposing strict conditions under which a distributor may be terminated or not have his agreement renewed, treads into areas where previously the American legal system generally preferred not to go.

What is of particular importance with regard to laws such as CEDA is how they define the word 'cause'. In the first instance, CEDA defines 'cause' as including a number of specific, wrongful acts that could be potentially taken by a distributor. One example could be a distributor who makes material misrepresentations to a supplier.<sup>14</sup> Such examples are not particularly noteworthy as they are self-evident, but what is of interest is the more general definition provided which states, 'cause means failure by an equipment dealer to comply with the requirements imposed upon the equipment dealer by the dealer agreement, provided the requirements are not different from those requirements imposed on other similarly situated equipment dealers in this state'.<sup>15</sup> This definition creates the unique requirement that the contract terms for termination must be harmonized among all distributors within the state, in this instance California.

Where this requirement of harmonization could become a real issue is with regard to contract conditions such as minimum sales targets as they would need to be the same as between distributors in California, unless the various distributors are not similarly situated. What 'similarly situated' means can also be somewhat difficult to quantify. Depending on the particular contract conditions in question, economic factors such as the size of the available market can dictate whether two distributors are 'similarly situated'.<sup>16</sup>

CEDA also prohibits suppliers from requiring distributors to enter into a supplementary agreement unless such agreement is imposed on all other distributors

5. See id. § 22 901 (a).

6. See id.

7. See id. Sec. (b).

8. See id. Sec. (d).

9. See id. § 22 902 (d).

10. See id. § 22 903 (b).

11. For an overview of the UCC see, Christom, Richard, *International Agency, Distribution and Licensing Agreements* 737 (4<sup>th</sup> ed. 2003).

12. Moreover, it is questionable that the UCC would apply to a distribution agreement as a whole.

13. One restraint may be termination provisions which are so one-sided that they cause the contract to fail for lack of 'consideration' (reciprocity of obligations). Certain types of industry specific regulations such as laws governing auto dealers, and alcoholic beverage dealers, do have rules which apply to the relationship between supplier and distributor.

14. See CAL. CODE, supra note 4, at § 22 903 (b).

15. See id.

16. See White, C., & B. Littlefield, *Arizona's New Equipment Dealer Protection Laws*, 30 Ft. Ariz. Atty. 20, 21.

within the state of California.<sup>17</sup> This further restriction on the relationships between supplier and dealer therefore means that a supplier is limited in some regards as to its flexibility pertaining to new products. There are instances where a manufacturer may wish, for instance, to use a 'phased' introduction of new products, and thus require each distributor to begin selling this new product at different times. This prohibition could hamper suppliers in situations where the debut of a new product requires new agreements to be entered into with distributors. It is therefore worthwhile for parties to consider some flexibility in this area when contracting with California distributors.

Pricing is also addressed under CEDA insofar as it does not allow for price discrimination between 'similarly situated' distributors within California.<sup>18</sup> Therefore, a distributor in San Francisco and one in Los Angeles must in theory be given the same prices for the goods. There are a number of exceptions under this rule, however, including pricing discounts offered by suppliers for larger quantity orders.

States which enact CEDA-like legislation may provide, as CEDA does, for the method under which suppliers may terminate distributors by requiring a supplier to notify the distributor at least ninety days in advance of termination.<sup>19</sup> Such a notification must be in writing and contain a list of the reasons for the termination as well as propose a sixty-day period during which the distributor has the right to rectify any problems listed in the notice. Again this is a departure from the normal approach of American contract law, as it is in essence a mandatory notice period and also a statutory right to cure in favor of the distributor.

After termination, CEDA requires a supplier to repurchase all stock held by the terminated distributor in storage.<sup>20</sup> There are provisions which compensate for wear and tear, and pricing discounts originally given by the supplier to the distributor, but in essence the entire stock of undamaged goods must be repurchased by a terminating supplier.<sup>21</sup> This provision constitutes a very substantial risk normally borne by the distributor, especially when he is being terminated as a distributor for his own default. In addition, CEDA requires suppliers to pay five percent of the net price (the price advertised in the supplier's catalogue) of a good to the distributor as compensation for the shipping and handling of goods sent back by the supplier.

### THE SCOPE OF CEDA

What has been set forth above are some of the more noteworthy aspects of CEDA, but what is of equal importance for American and non-US businesses alike are the limits to which legislation such as CEDA can be applied. This is a crucial question because as has been mentioned already, if laws like CEDA do not apply, the likelihood that the terms of the parties contract will

determine the legal rights between them as opposed to legislation is quite strong. It is in this regard that CEDA can provide a number of surprises to parties who may be contracting or under a contractual choice of law which implicates legislation like CEDA.

CEDA is what is often described as 'mandatory law', which is to say that parties cannot opt out from it in their contract choice of law clause. CEDA specifically states as follows:

'A provision in any contract or agreement with respect to a supplier that requires jurisdiction or venue or forum outside of this state or requires the application of the laws of another state is void with respect to a claim otherwise enforceable under this chapter.'<sup>22</sup>

This language essentially means that for suppliers working with distributors in California (or states with similar laws), CEDA cannot be avoided by choosing the law of another country, state or jurisdiction to apply to the contract. Thus any choice of law other than California's may be void in a contract that is to be executed in the state. Any jurisdictional or forum choice other than California courts would also be considered null and void in such a situation. This can have a particularly chilling effect on the normal dispute resolution methods employed in cross-border trade, such as the use of international arbitration. It would appear that under CEDA dispute resolution clauses which call for the use of International Chamber of Commerce arbitration to be held in Europe, for example, as between a foreign supplier and a California distributor, would be void.

Choosing the law of a jurisdiction with laws similar to CEDA in contracts which are primarily being performed outside of that state can also lead to the application of laws such as CEDA. This was confirmed in a recent US Court of Appeals for the 9<sup>th</sup> Circuit decision (the Federal appeals court which covers California), *Gravquick A/S v. Trimble Navigation Ltd.*<sup>23</sup> In this case, a distribution agreement had been concluded between a California supplier (Trimble) of global positioning equipment and a Danish distributor (Gravquick). The law of California was chosen in the contract. The Danish distributor was appointed under the agreement to be the distributor within Denmark and after the conclusion of the agreement, the California supplier assigned the administration of the contract to its UK subsidiary. The contract had an automatic termination provision which dictated that unless the

17. See CAL. CODE, supra note 4, at sec 22 902 (b).

18. See id. Sec. (f).

19. See id. § 22 903 (a).

20. See id. § 22 905 (a).

21. See id. Sec. (b).

22. See id. § 22 927.

23. See *Gravquick A/S, Italics v. Trimble Navigation International Limited*, 323 F.3d 1219 (9th Cir. 2003).

supplier renewed the agreement, the agreement would automatically expire, which is what took place.

*Gravquick* is important with regard to the scope of CEDA for at least two reasons. The distribution agreement in that case, which was performed completely in Europe between two European companies, and applied to the distribution of goods within Denmark, would not seem to warrant the application of legislation which for all intents and purposes appears to be directed towards protecting California distributors. However, this was not the conclusion of the court in *Gravquick*. Noting that the text of CEDA itself did not have any territorial restrictions within it, and also that the choice of law clause in the distribution agreement broadly selected the application of California law without making any caveat regarding the application of CEDA, the Court stated, 'If a state law does not have limitations on its geographical scope, courts will apply it to a contract governed by that state's law, even if parts of the contract are performed outside of the state.'<sup>24</sup>

Consequently, in this case, a Danish distributor, selling goods in Denmark and dealing primarily with a UK supplier, received the full protection of CEDA's provisions regarding termination. This does not mean that every selection of California law within a contract will invoke the application of CEDA, however. The mandatory application aspect of CEDA is limited to those contracts wherein CEDA would otherwise apply were it not for the choice of law. Thus, where two parties contract for the use of California law in a distribution contract involving a distributor outside of California (where another law would normally apply to the relationship) parties may exclude the application of CEDA should they choose Californian law to govern the relationship. In such cases, it would be important for the counsel responsible for drafting the agreement to indicate their preference for or against CEDA in their choice of law clause.

A second aspect of *Gravquick* which raises issues as to the scope of CEDA's application is the fact that the contract was for the distribution of global positioning equipment. This fact broaches the question of what kind of products fit within the scope of CEDA. The relevant provisions of CEDA state that it applies to equipment which is designed for or adapted for use in the 'agriculture, livestock, grazing, light industrial and

utility equipment' industry, thus seemingly excluding products which are incidental to those industries. However, *Gravquick* did apply CEDA to a distribution contract for global positioning equipment which may have use in one of the aforementioned industries, but certainly would not be designed specifically for those business sectors. It would appear, therefore, that there is some uncertainty as to exactly what types or categories of products fall under CEDA.

A later court decision by a lower federal trial court in California addressed this issue, and attempted to shed light on the question. In a case involving a supplier and distributor of water meter equipment (equipment used for taking various measurements of water type, volume or temperature) called *Badger Meters Inc., v. Vintage Water Works Supply, Inc.*, the court felt that since the *Gravquick* decision, which it would normally be bound to follow, did not directly address the scope of the application of CEDA in terms of types of equipment that are sold, it could engage in its own analysis.<sup>25</sup> Therefore it came to the conclusion that CEDA was primarily aimed at the agricultural sector, and more specifically large equipment distributors and not the distributors of smaller non agricultural specific equipment such as water meters.<sup>26</sup>

While the *Badger* decision would seem to narrow the application of CEDA, it is useful to keep in mind that this was a lower court's decision. CEDA's reach in terms of what kind of distribution agreements it can apply to is still somewhat uncertain, and therefore parties who are contracting under California law or in states with similar laws should be wary of this fact.

#### CEDA COMPARED TO THE DUTCH CIVIL CODE

In the Netherlands there is no specific legislation comparable to American laws such as CEDA.<sup>27</sup> Distribution agreements are governed by the provisions of the Dutch Civil Code (DCC), which apply to all agreements. In this context, the parties' 'freedom of contract' is the starting point in any analysis as in principle, parties are free to choose the contents of their distribution agreement. However, article 6:248 DCC, which deals with the legal effects of contracts, plays a crucial and even decisive role in specific aspects of distribution contracts. The provisions of this article may have a corrective effect on contracts if the consequences of a particular provision are considered too harsh or if the parties to the contract forgot to include certain provisions.<sup>28</sup>

In the case law which has developed regarding distribution agreements it is those clauses dealing with duration and termination of the agreements as well as compensation owed to distributors in the event of termination, that have at times been judged to be in violation of 6:248 DCC.<sup>29</sup>

24. See *id.* at 1223.

25. See *Badger Meter Inc. v. Vintage Water Works Supply*, 341 F. Supp. 2d 1115, 1121 (N.O. Cal. Dist. Court 2004).

26. See *id.*, p. 1122.

27. For background reading on a comparison between Dutch law and American law, consult C.A.M. van de Paverd, *De opzegging van distributieovereenkomsten*, Amsterdam: Kluwer Rechtswetenschappelijke Publicaties, 1999.

28. Article 6:258 DCC contains a specific provision for unforeseen circumstances.

29. Furthermore, in addition to the DCC, Dutch and European competition law may apply to distribution contracts. This topic shall, however, not be discussed in this article.

Even though Dutch case law deals differently with issues such as duration and termination of agreements, as well as compensation, than legislation like CEDA, the underlying concepts regarding the inequality of the parties and in particular the need for protection of the distributor, which is generally considered to be the weaker party, can be found in both. As described above, CEDA does contain specific provisions regarding, for example, the default of the distributor and termination of the distribution contract which are clearly directed towards the protection of the distributor. A comparable approach can be found in Dutch case law, especially in regard to the distributor's rights upon termination.

With respect to the termination of distribution contracts, Dutch case law distinguishes between two types which can essentially be described as those distribution agreements concluded for an indefinite period of time versus agreements concluded for a fixed period. The basic rule for the first type of distribution agreement is that they can be terminated at any time, unless this is at odds with the language of the agreement. The availability of a termination clause is not required. In order to terminate a distributor in such circumstances, due notice would suffice, provided that a reasonable notice period is taken into account.<sup>30</sup> However, a termination without grounds is, in principle, not allowed. If a contractual provision regarding termination is not available, the issue as to whether the termination was proper will have to be answered in the context of the standards of reasonableness and fairness in combination with the circumstances of the case.<sup>31</sup>

Dutch case law is clear, however, that a distribution agreement concluded for a limited period of time cannot be terminated prematurely unless there are unforeseen circumstances that justify such termination.<sup>32</sup> If there are no such unforeseen circumstances and the agreement does not include a provision allowing for such termination, premature termination of this kind of agreement is not allowed.

In situations where the parties have used their contractual freedom to include in their agreement a provision regarding the termination of the distribution agreement, such a clause would generally govern any termination situation. However, depending on the contents and effects of such a clause in relation to the entire agreement, the standards of reasonableness and fairness can be used to set aside certain provisions if they are considered to be unacceptable or too harsh.<sup>33</sup> One such example would be a provision allowing for immediate termination without the requirement of taking into account any period of notice. The same could be said for provisions regarding compensation.<sup>34</sup>

Even though the courts have reticence regarding setting aside provisions in an agreement, they may do so under certain circumstances as described above or in cases where there is a discrepancy between the provision itself and the nature of the distribution agreement.<sup>35</sup>

Default by the distributor, in so much as they fail in the performance of their obligations can be grounds for termination. In the event of non-performance of contractual obligations, however, Dutch law does require a notice in writing in which the distributor is given a reasonable period of time to remedy their default.<sup>36</sup> If the distributor fails to remedy the default, the supplier may terminate the distribution agreement. In this regard, Dutch law is similar in its protection of distributors as legislation such as CEDA. In the event the performance is impossible, however, such written notice is not required.<sup>37</sup>

Termination of a distributor by supplier can take place without the necessity of taking into account a notice period, but in such circumstances there must be a cause for immediate termination. However, even in such circumstances, the terminating party shall have to inform the other party of the grounds for termination at the moment thereof. If doubt lingers with regard to the legitimacy of the grounds of termination, one would be well-advised to provide a notice in advance of the termination in which the other party has the right to rectify the grounds for termination within the period mentioned in the notice. An example found in case law of circumstances under which immediate termination was justified, included a situation wherein the director of a company acting as a distributor was suspected of engaging in a fraudulent scheme relating to the products that were the subject of the agreement with the supplier.<sup>38</sup>

Upon termination of the distribution agreement, the distributor may be entitled to compensation. The standards of reasonableness and equity, which should be used in the determination of whether the distributor was owed any type of notice, will also be applicable to the issue of compensation. Lack of notice on the part of the supplier may also lead a court to award compensation to a distributor, if it is determined that the terminated party should have been granted some advance notice. In other words, if the supplier terminates using a period of notice that is considered too short in relation to the duration of the distribution agreement's term, the

30. Dutch Supreme Court 21 July 1991, *NJ* 1991, 742. See also Dutch Supreme Court 21 April 1995, *NJ* 1995, 437.

31. Dutch Supreme Court 15 April 1966, *NJ* 1966, 302, Dutch Supreme Court 3 December 1999, *NJ* 2000, 120 and for a commentary on this case law I.S.J. Houben, 'Opzegging distributieovereenkomst', *Bb* No. 1, 31 January 2000, p. 1-3.

32. Dutch Supreme Court 21 October 1988, *NJ* 1990, 439.

33. See e.g. Dutch Supreme Court 30 November 1990, *NJ* 1991, 187.

34. J.M. Barendrecht and G.R.B. van Peurse, *Distributieovereenkomsten*, (Serie recht en praktijk) Deventer: Kluwer 1997, p. 174 and 175.

35. This follows from article 6:248 DCC, which gives 'the nature of the contract' a crucial role in assessing the effects of the contract between the parties.

36. See article 6:74 and 6:82 DCC.

37. See article 6:74 and 6:83 DCC.

38. District Court Breda (summary proceedings) 25 May 1988, *KG* 1988, 248.

distributor may receive compensation for the period the notice period fell short.

One ground for compensation due to a terminated distributor is for example unjust enrichment. If the distributor makes considerable investments, for which he has not had the time to recover the costs it incurred the supplier may have to compensate the distributor for that value if it profited from these investments.<sup>39</sup> Furthermore, the distributor may receive a compensation for the costs it had to make regarding the redundancy of employees if these costs are considerable. The Dutch Supreme Court ruled, however, that the distributor is only entitled to such compensation under extraordinary circumstances.<sup>40</sup> With respect to goodwill, the distributor has generally no legal entitlement to receive compensation, however, under certain circumstances, if all the distributor's customers fall to the supplier, a claim may be granted based on unjust enrichment.

If the distribution agreement does not contain a regulation regarding the situation of the parties after termination, article 6:248 DCC also plays an important role. If the distributor, for example, still has stocks of goods in their warehouse, under certain circumstances this article may obligate the supplier to buy these stocks from the distributor. In this respect Dutch law also grants protection to a distributor in a manner similar to American legislation that adopts the CEDA approach.

## CONCLUSION

Both in the United States and the Netherlands there is a consistent trend in the legal community toward favoring extra protection for distributors in their relationships with suppliers. While the Dutch Civil Code does not contain specific articles which protect the distributor per se, certainly the more general case law points to an approach which favors giving the distributor extra rights. On the other hand, as laws similar to CEDA are being enacted in the US in order to codify what may be characterized as extensive protective measures in favor of the distributor, their application is intended to be limited to certain commercial sectors, leaving vast areas of commerce free to operate under the rather loose strictures of general American contract law.

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39. Dutch Supreme Court 21 June 1991, *NJ* 1991, 742; see also J.M. Barendrecht, 'De redelijkheid en billijkheid en einde van de distributie-overeenkomst', *NJB* 1994, p. 561-566 and F.M. Smit, 'Opzegging van distributie-overeenkomsten: naar een werkbaarder systeem', *NJB* 1994, p. 567-569.

40. Dutch Supreme Court 21 June 1991, *NJ* 1991, 742.