

# Evaluating Transfers and Terminations in Increasingly Consolidated Reseller Networks

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Over the past few years, many manufacturing industries have faced a new trend: reseller (i.e., distributor or dealer) consolidation within channel networks. From the manufacturer's standpoint, there is clear upside to this trend. Larger resellers offer a predictable product and often are on a stronger financial footing, have more refined marketing tools, and are better able to predict the ebbs and flows of the industry, and thus the needs of customers. But there are inherent challenges, too. Larger resellers mean a consolidation of risk in a reseller (or a handful of similarly sized resellers) with more leverage. Having even a single large reseller within your network can create problems for the individual resale relationship and for the network as a whole. That problem is amplified when your network includes a handful of large resellers. While some problems evolve over time, after the act of consolidation occurs, many are (or should be) obvious to manufacturers beforehand.

To make the problem palpable, take the following scenario: Company A, which has a resale agreement with Manufacturer A, wants to sell its business to Company B. Company B's ultimate parent is Manufacturer B, the arch rival of Manufacturer A. If Company B acquires Company A, Manufacturer B will likely have access to competitive information about Company A's historical relationship with Manufacturer A. But given state equipment distributor/dealer laws (which often require "good cause" to end resale relationships), not stopping this transaction before it occurs could have catastrophic consequences. Clearly, this would be an untenable result for Manufacturer A.

This is not to say all consolidation is bad. The key, of course, is for manufacturers to separate the wheat from the chaff *before* the consolidation event – typically, the merger or acquisition – actually happens. Only by doing this can manufactures maintain control of their networks and, by extension, their brands.

## Tips on Evaluating Transfers

Manufacturers typically exercise substantial caution in vetting potential resellers before beginning long-term resale relationships, and most state laws allow manufacturers to exercise that same

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caution when presented with a proposed transfer. Maintaining control begins with the process of evaluating which transfers to approve and which not to.

The most important consideration in approving or denying a transfer is ensuring that your reseller agreement gives you the right to approve a transfer. It's hard to exercise control if you didn't grant yourself the right to do so.

Once you have the right memorialized, the next thing to check is the applicable state distributor/dealer law. Such laws commonly place restrictions around the manufacturer's right to approve but also allow for a denial under appropriate circumstances. Some common features of these laws include:

- Notice of proposed transfer from the dealer, to which the manufacturer must respond by either approving the transfer or denying it (typically with the grounds for denial specified). Some states specify the form of the notice or specify the information that must be exchanged between the parties as part of notice process.
- Typically, a manufacturer must respond to a proposed transfer within a certain timeframe following the proposal (60 days is common). Be aware that some states specify that a proposed transfer is deemed approved if not rejected in that timeframe.
- In many states, a manufacturer may not "unreasonably" withhold consent. (Additionally or alternatively, the manufacturer may not prevent the dealer from obtaining fair and reasonable compensation for the value of the business.) Whether or not a rejection is "reasonable" is often determined by looking at criteria or qualifications normally required of existing or prospective dealers. Additional considerations include whether the transfer would be "substantially detrimental" to the manufacturer and whether the manufacturer's decision was "arbitrary."
- Some states specify factors that may not be considered in evaluating a transfer, or they specify factors that may be considered but which standing alone are insufficient grounds for rejecting a transfer.

Be aware that some states distinguish between transfer of dealership as a whole, the assets of the dealership, and partial ownership interests in the dealership, and that a rejection can give the dealer the right to file a lawsuit to challenge the manufacturer's decision. The rights bestowed, however, are upon your dealer, not the party to which they are proposing to transfer the dealership.

For manufacturers considering termination as a result of an untenable reseller transfer like the one described above (or for other independent reasons), there are both practical and legal issues to consider.

## **Tips on Evaluating Terminations**

The choice to terminate a reseller can be a difficult one. Manufacturers must consider not only the business consequences of a termination but also the legal risks that materialize with a botched termination. There are a number of practical steps that manufacturers can take to both increase the likelihood of a successful termination and reduce their exposure to the uncertainty, distraction, and expense of litigation.

*First things first:* Does the termination pass the fairness test? As you build your rationale for terminating a reseller, consider what a judge or jury might say in response to your case for termination. Think critically about whether your answers to questions like the following will present

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your decision in a good light before the judge or jury.

- Are you unfairly singling out this particular reseller (e.g., did your other resellers consolidate without your objection)?
- Are you dumping this reseller for legitimate reasons, or is it really because you'd prefer a different reseller handle the territory in question?
- Do you have a uniform process in place for evaluating your resellers or their proposed transfers?

These optics matter. Most states require “good cause” to terminate a reseller, and although different states have different standards for what constitutes “good cause,” it will always be more than just a contractual right to terminate. You will likely need to demonstrate that you have “good cause” at some point before the termination is complete, so make sure that you have your story straight and it passes the fairness test before you initiate a termination.

*Second*, get your termination notice right. Make sure you know how you are supposed to notify your reseller under both your contract and any relevant state statute. You may need to allow time to cure a defect. There may be a waiting period. You may have to include your justification for termination in the notice. Any or all of these may be requirements for you to provide proper notice to a reseller, and each of them could form a basis for legal liability if disregarded.

*Third*, do not sugarcoat your termination notice, and do not rely on things you cannot substantiate – be direct and honest. Rely on the facts and circumstances within the reseller's control to justify your decision. Take an interest in the details. How a difficult message is conveyed, and by whom, can make a big difference in how the message is received. Having lawyers send a termination notice may signal that you're expecting a fight in a way that delivering a sincere letter from a business partner may not. Making termination easy to hear and digest for your reseller can reduce the likelihood of a lawsuit.

*Fourth*, do not concede the applicability of any state statute. There can be many reasons a given state dealer/distributor statute does not afford a reseller protection from termination. Your termination notice will be “Exhibit A” to any terminated reseller's complaint filed against you, and a concession that a particular state statute applies may forestall your later attempt to argue the statute is inapplicable.

*Last*, give your reseller a reason to go away quietly. As a manufacturer, there are ways that you can ease the transition a terminated reseller will experience. Are you able and willing to repurchase inventory regardless of whether an obligation exists? Maybe you can waive a contractual non-compete clause without serious consequences. Even providing a lump sum payment to a reseller may give them an incentive to avoid litigation, and it may be cheaper in the long run. These efforts can go a long way toward ending a business relationship on good terms and avoiding unnecessary acrimony.

Terminating a reseller requires careful planning and precise execution to avoid practical and legal pitfalls. These tips are meant as both an aid and a warning. Manufacturers who intend to terminate a reseller need to approach the situation strategically to avoid the risk of ill will or, worse, a lawsuit.

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