

# CLIENT ALERTS

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## Breaking-Up: What Suppliers Need To Know Before Terminating Their Distribution Agreement

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A recent federal court decision provides cautionary guidance for manufacturers or suppliers planning on terminating their dealers in a distributorship. In *Keen Edge Co, Inc, v Wright Mfg, Inc*, No. 19-1673, 2020 WL 4926664 (ED Wis, Aug. 21, 2020), the court held that the manufacturer was not allowed to terminate its business relationship with an exclusive dealer—temporarily trapping the manufacturer. Wright Manufacturing Inc. (Wright), a manufacturer of lawnmowers, was contracted with Keen Edge Company (Keen Edge) for exclusive distribution of its lawnmowers throughout the Midwest for nearly 40 years. In exchange for exclusivity, Keen Edge was required to meet sales goals and contribute to rebate funds and invest in specific Wright inventory.

After a change in leadership at Wright in early 2019, Wright began the process for terminating its exclusive distributorship with Keen Edge. Wright made an on-site visit to Keen Edge to address performance complaints, issued a letter to Keen Edge identifying sixteen areas of improvement, and then had a follow-up meeting to address the deficiencies set forth in the letter.

Wright, however, never followed-up to assess Keen Edge's progress. Keen Edge continued to perform as a dealer, including attending territory manager meetings, drafting a sales and marketing budget for 2020, and proposing dealer program terms, which Wright accepted. Then, after many months, Wright gave notice that it was going to terminate Keen Edge's dealership within 30 days. Wright failed to provide a clear reason for termination; it only made general reference to the deficiencies identified in its previous letter. Keen Edge was also not given the opportunity to cure alleged deficiencies. Litigation ensued.

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The federal court granted Keen Edge's motion for a preliminary injunction, preventing Wright from terminating Keen Edge's position as an exclusive dealer. The court ruled that Keen Edge had shown a likelihood of success that Wright had violated Wisconsin law, which protects dealerships from sudden or improper termination of their contract with the business who granted the dealership. Specifically, Wright had failed to provide proper notice of termination, failed to give Keen Edge proper time to cure any deficiencies, and termination was not made for "good cause." The court similarly found that Wright had likely violated Illinois, Indiana, North Dakota, Missouri, and Minnesota law in terminating the distribution agreement. These states have protective trade statutes with comparable requirements of dealers/grantors and require termination for "good cause." The court ultimately preserved the status quo for Keen Edge's exclusive distributorship during the litigation—meaning Wright is temporarily trapped with this business relationship. This case remains pending, and Butzel Long will continue to monitor it.

### **Recommendations for Your Business**

The following are general recommendations for your business if you are planning to terminate a distribution agreement with a distributor or dealer (or inversely if you have been notified of termination or have been terminated of your distributorship).

1. The starting point should be the distribution agreement. You should carefully review the agreement to ensure that your reasons for termination are permitted under the agreement's terms. Any failures by the distributor to follow its contractual obligations may support "good cause" for termination (discussed below). You should further analyze the procedural provisions for termination, such as any notice requirements. To minimize liability, you should consult with counsel for review of the distribution agreement.
2. Your right to terminate a distributorship is governed not only by contract, but by state and federal laws. Many states have protective trade statutes that provide greater protections for the distributor when termination is threatened by a supplier regardless of the parties' contractual terms. These laws vary widely from state to state, but often require "good cause" for termination, notification of termination, and a period for the distributor to cure performance deficiencies. Federal law may also provide protections for distributors depending on the industry and business relationship. As demonstrated in *Keen Edge*, suppliers should carefully follow any applicable law before termination. Consulting with counsel to comply with both your contract and applicable state laws before terminating the distributorship will likely protect you from liability down the road.
3. Moreover, you should understand applicable state laws before contracting in the first place. As always, it is far easier to protect yourself before your contract is executed, rather than when a dispute arises within the distributorship.
4. Your rationale for termination should be factually supported. The basis for termination should meet the governing state's "good cause" standard and must be rooted in fact. For example, if the distributor has failed to meet its sales obligations, then you should support these performance deficiencies with documentation. It is also important that you consistently apply distribution requirements and reasons for termination throughout your distribution network. Put simply, don't

## CLIENT ALERTS

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give other distributors special treatment. Proper documentation and consistent business practices are critical for any future litigation.

5. Subject to applicable law, you should provide adequate notice of termination to the distributor and provide the distributor with an opportunity to cure specific performance deficiencies. Timeframes for the notification and cure period are ordinarily set by state law. Again, please consult with counsel for compliance with these statutory notice requirements.
6. Following termination, you should consider any post-termination issues that may arise such as protection of trade secrets or confidential business information and enforceability of non-compete agreements.

Termination of a distribution agreement is a significant business decision, especially if it was a long-standing and previously profitable relationship. It is imperative to follow any governing law on termination and support your rationale for termination with factual evidence to protect your business. Butzel Long is ready and willing to counsel your business regarding termination of a distributorship. If you have any questions or compliance concerns, please feel free to contact us.

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