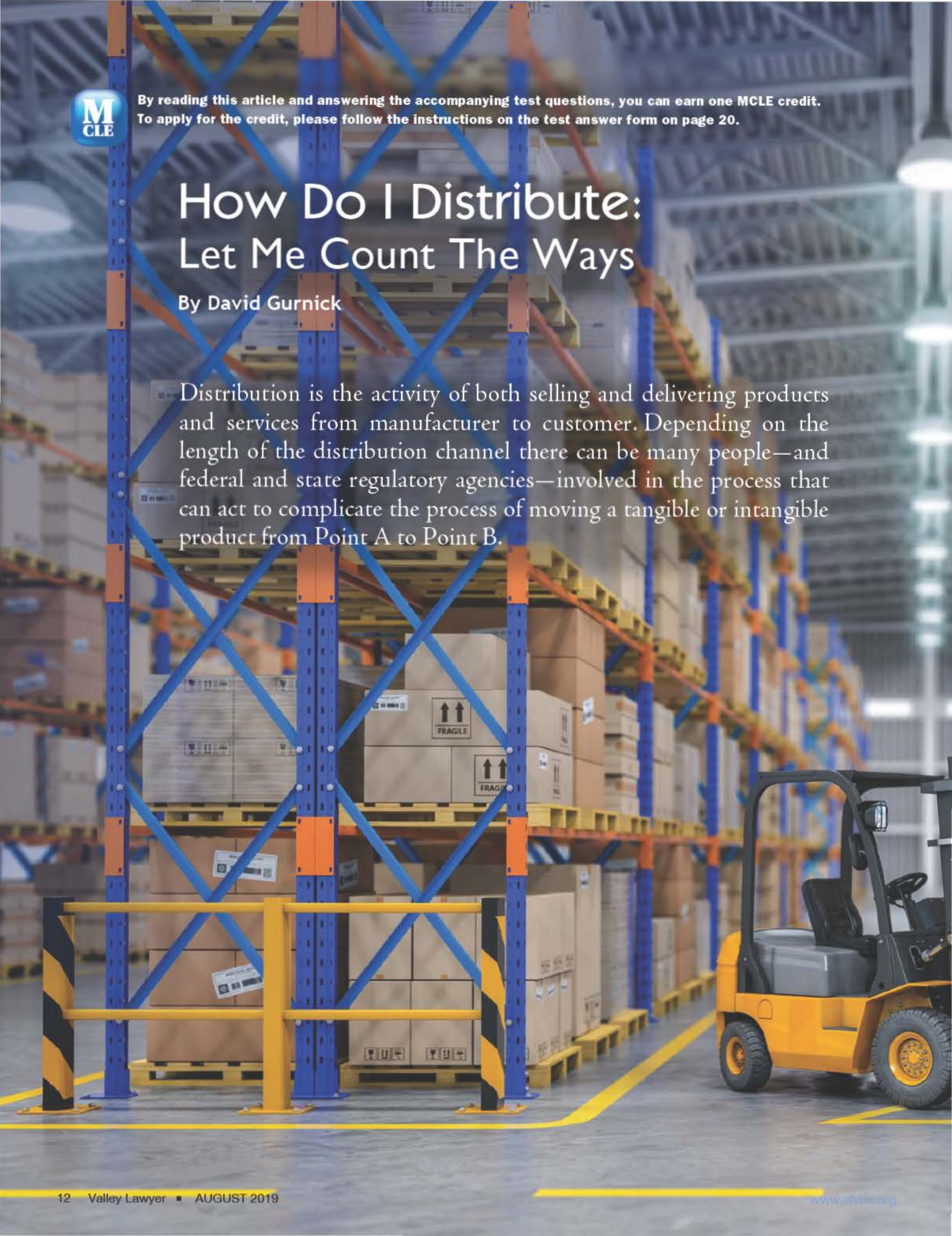

By reading this article and answering the accompanying test questions, you can earn one MCLE credit. To apply for the credit, please follow the instructions on the test answer form on page 20.

How Do I Distribute: Let Me Count The Ways

By David Gurnick

Distribution is the activity of both selling and delivering products and services from manufacturer to customer. Depending on the length of the distribution channel there can be many people—and federal and state regulatory agencies—involved in the process that can act to complicate the process of moving a tangible or intangible product from Point A to Point B.


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MANUFACTURERS AND RESELLERS HAVE MANY ways to place their goods and services into the stream of commerce, while the government has many ways to regulate distribution methods. This article discusses various modes of distribution and how each is regulated.

Defining 'Distribution'

The most basic distribution method is for one to create a product and sell it. This can be called "direct distribution". A farmer who grows a product and brings it to the market for sale engages in direct distribution. So does a restaurant that prepares meals for customers and receives payment. This method of distribution is sometimes called "cash-and-carry." The term can apply to any business that sells merchandise and receives payment at or about the time of sale.[1]

Today, the term "cash-and-carry" also commonly applies to sales made on short term credit, such as payment by credit card. As an example, Apple makes iPhones and sells them through company-owned stores where customers can pay with cash or, more commonly, by using their credit cards.

Direct distribution is the least regulated form of conducting sales. Neither the federal nor state government regulates this as a method of distribution. But this does not mean such businesses are unregulated.

A typical business in any field is subject to federal, state and local laws regulating any number of concerns—by way of example, the construction of physical premises; zoning, parking, health, safety and welfare of customers, workers and the public, sanitation; inspections by government agencies; employment practices; the restrictions on hiring persons not authorized to work in the United States; minimum wage; any restrictions on smoking; insurance for employees; taxes and withholding; the collection and payment of sales tax; fire safety and emergency preparedness; the use, storage and disposal of waste and hazardous materials; and nondiscrimination as to customers, employees and others.

Obviously, laws addressing many more subjects, as well as laws specific to the industry and activities of business also apply.

Working with Representatives, Dealers and Distributors

Next, one may engage representatives to sell one's product. Representatives can be sales agents, dealers or other kinds of distributors. Representatives solicit potential customers who then buy direct from the manufacturer.

A California statute—the Independent Wholesale Sales Representatives Contractual Relations Act—seeks to protect commission-based sales representatives against perceived mistreatment by companies whose products they represent.[2]

According to the statute, a company in the state that uses outside sales representatives who are to be paid by commission must have a written agreement. The agreement must address the rate and method of computing commissions, when commissions will be paid, the sales representative's assigned territory, any chargebacks and any exceptions the representative is subject to with regard to territory and customers.

The California company must also provide its representative a copy and get a receipt for having done so and must provide the representative with an accounting of orders for which payment is made, the commission rate for each order, and details of any chargebacks.[3] A company that violates the statute can be subject to triple damages.[4]

Dealers and distributors buy inventory of a product, and resell from that inventory for their own account. The chain of product distribution, from manufacturer to end user, commonly includes dealers and distributors as links in the chain.[5]

Thus, as examples, Ford Motor Company and other car makers manufacture automobiles. These companies do not sell their products directly to consumers. Rather, their products are sold through dedicated Ford dealers, or sellers of other specified brands. Home appliances, household furnishings, clothing, food and agricultural products, pharmaceuticals, and the seemingly infinite varieties of other tangible products, and increasingly many kinds of services, are sold through resellers, such as distributors and dealers.

In a sense, retail stores, whether grocery, department, sporting goods, home furnishings, mattress or the countless varieties of independent stores in shopping malls, strip centers and along commercial streets, are examples of independent distributors. They buy products supplied by others, hold them in inventory, and advertise, display and resell them to the public. So are companies that buy, warehouse and resell industrial goods.

When an individual proprietor succeeds so well as to grow its number of distribution points, or, in other words, to grow its number of retail stores, it has become a chain distributor.

In 1950 Sam Walton opened a variety store called Walton's 5 & 10 in Bentonville, Arkansas. Twelve years later, he opened the first Wal-Mart store. Today, Walmart has thousands of stores nationwide and internationally.[6] Auto Zone, .99 Cents Only, Best Buy, Grainger and Nordstrom are additional examples of chain distributors.

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Working with Suppliers

Suppliers have a strong interest in helping resellers maintain and grow sales. More sales by a reseller means an increase in sales by the manufacturer to the reseller.

Thus, everyone profits with suppliers able to provide additional assistance to their resellers such as, advertising, training reseller personnel in the use of the product, staffing and merchandising assistance at retail stores, the payment of slotting fees, sharing or reimbursing advertising expenses, consulting on product usages, conducting sales and other promotions.

Resellers sometimes become strongly associated with a supplier. As a result, a retail store may become known for one or more brands of products distributed. In earlier times, examples included appliance stores that might display signage for such brands as Maytag washer/dryers or Orrick vacuum cleaners. Today, it is common for a mattress store to display signage of the product brands they sell, for example, Beautyrest, Certa, Sealy and Simmons.

A supplier may provide so much assistance that the aid, in effect, amounts to a marketing program for its reseller. When a supplier provides a marketing program, allows the reseller to become strongly associated with the supplier's brand, and charges the reseller any kind of a fee, the relationship may be in actuality, a business franchise—a distribution method in the United States that has roots dating back to the late 1800s and has grown most substantially over the past 50 years.[7]

Today, the public does business with countless franchised businesses including quick service restaurants such as, McDonald's, Burger King, real estate services like Century 21, Union 76 and ARCO gasoline stations, Hilton and Marriott hotels, and numerous other businesses.

Federal and State Regulations

A rule of the Federal Trade Commission that has nationwide application, as well as statutes in 13 states, have established an extensive body of regulation of offers and sales of business franchises.[8]

These rules require the preparation of an extensive Franchise Disclosure Document that must be presented to prospective franchisees, followed by a cooling-off period of at least 14 days, before any agreement is signed or any money is paid in relation to a franchise. In states with franchise laws, an additional regulatory layer consists of a review of the Franchise Disclosure Document by a state examiner.

California and approximately 25 other states regulate the ongoing franchise relationship. Those states restrict a franchisor from terminating a franchise agreement before the expiration of its agreed term and restrict a franchisor from refusing, at the end of the term, to renew a franchise if the franchisee wishes to renew. Early termination or nonrenewal may not occur over the franchisee's objection, unless the franchisor has good cause for its decision to terminate or not renew.

Good cause is defined in each statute, typically involving breaches of the franchise agreement that the franchisee fails to cure after being given notice and a reasonable opportunity to do so, endangerment of public health or safety, abandonment of the franchise and a few other specified circumstances.[9]

California goes so far as to restrict business franchisors from interfering with franchisees who wish to associate with each other.[10]

Consignment Sales

One more type of distribution method is consignment sales.

Consignment occurs when a supplier, called a consignor, provides its product to another, called a consignee, without transferring title. The consignee is authorized to resell the product and keep part of the sale price, while turning over the rest of the price to the supplier.

As described in the courts, "a consignment is nothing more than a bailment for care or sale, wherein there is no obligation of purchase in the consignee."[11] Thus, a consignment "creates an agency pursuant to which goods are delivered to a dealer for the purpose of resale; the consignor usually requires the consignee to charge a certain price for the goods."[12]

Farm-fresh produce is often placed in the chain of distribution in this manner, being placed with resellers sometimes called commission houses. The reseller does not own the produce, but sells it to another distributor, keeps a commission on the sale price, and remits the rest to the supplier.

This method makes sense because the market price of wholesale produce fluctuates continuously so that it would be difficult for the farmer to set a fixed price and equally difficult for the reseller to agree to it.

Many retail antique and used goods stores use the consignment method. Individual owners provide merchandise for display on consignment. This lets the store operator present vintage clothing and eclectic household relics for sale without having to incur any investment in inventory. This is important because the uniqueness of each item means the store owner lacks reliable knowledge about how much time will be needed for any particular item to be sold.

Multi-Level and Seller-Assisted Marketing

Another distribution method—multi-level marketing—is, in some ways, a development over recent decades, but in other ways has been around a long time.

This is sometimes called "network" or "pyramid marketing." This characterization is often pejorative, as the reference to a pyramid recalls the infamous Ponzi schemes of the 1920s.[13]

While multi-level marketing is not against the law, it has been criticized as involving deception in the promises made to participants.[14] The Federal Trade Commission also has expressed concern that aggressive multi-level marketing programs may be deceptive and unlawful pyramid schemes.[15]

Yet another distribution method is related to franchising. It consists of a supplier providing assistance in starting a business that creates merchandise for sale back to the originator, or in which the originator commits to assist in providing locations for sales of merchandise, such as vending machines, or displays of items like jewelry.

California calls this method a Seller Assisted Marketing Plan, while other states refer to this as sales of business opportunities.

In this distribution method, the supplier makes a commitment that it is in need of and will purchase products made by the investor, or that it will provide locations for resale of the merchandise, or provides some other assurance of success.[16]

Licensing is another method. This occurs when the owner of a valuable brand name, cartoon character or other intellectual property grants permission to a third party to display or otherwise use that property whether on the third party's products or in the conduct of its business.

Professional sports teams, universities, entertainment companies, and even industrial companies generate large revenues from licensing their names and characters for use on toys, clothing and any number of items.[17]

Merchandise Making Licensed Use of Third Party Names and Characters

Patent owners, by virtue of their position, possess for a period of time, a limited monopoly to make or use the inventions embodied in their patents. Patent owners often grant licenses letting others use their patented inventions, in exchange for the payment of royalties.

Trademark, copyright, trade secret, and patent licenses typically require licensees to follow guidelines and comply with restrictions while using the name, character, secret or invention. Fundamental to most licenses is the requirement to pay royalties to the intellectual property owner.

Other Regulation of Distribution Methods

The federal government and California, as well as some other states, have regulations that focus on particular industries.

The Federal Petroleum Marketing Practices Act and portions of the California Franchise Investment Law, apply specifically to the offers, and sale and terminations of gas station franchises, while the distribution of alcoholic beverages and of automobiles each have their own regulations.[18 19]

An ongoing development is the wave of legislation moving toward legalizing the distribution of cannabis products. These too are subject to particularized schemes of regulation.

Seller Assisted Marketing Plans or Business Opportunities are regulated by laws similar to the franchise laws. These too consist of a regulation of the Federal Trade Commission having nationwide application, and laws in several states.

Typically, these too require preparation of a disclosure document, presentation to a prospective investor and allowing a cooling-off period to pass before signing. Business opportunity laws also typically require the promoter to post a bond.[20]

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[1] See e g., *In re Micro Innovations Corp.*, 185 F.3d 329, 332 (5th Cir. 1999) (Supplier who requires payment in cash at the same time he releases goods, "is engaging in a cash and carry transaction.").
[2] Cal. Civ. Code Secs., 1738.10 et seq.
[3] Cal. Civ. Code Sec. 1738.13.
[4] Cal. Civ. Code Sec. 1738.15. See e.g., *Reilly v. Inquest Technology* 218 Cal. App. 4th 536 (2013) (affirming award of triple damages for violation of the Act).
[5] See e g., Solomon and Joffee, *Exclusive Distribution and Antitrust*, 53 Fordham L. Rev. 491, 491 n.1 (1984) ("We use the terms 'distributor' or 'dealer' generically to refer to distributors, retailers, or other firms in the chain of distribution between manufacturer or supplier and ultimate consumer.").
[6] Schragger, *The Anti-Chain Store Movement, Localist Ideology, and the Remnants of the Progressive Constitution*, 1920−1940, 90 Iowa L. Rev. 1011, n.444 (Mar. 2005).
[7] See, Gurnick and Vieux, *Case History of the American Business Franchise* 24 Okla. City U. L. Rev. 37 (1999).
[8] The FTC Rule is codified at 16 C.F.R. Secs., 436.1 et seq. The California Franchise Investment Law is at Cal. Corp. Code Secs., 30,000 et seq. Other states that regulate the offer and sale of franchises are Hawaii, Illinois, Indiana, Maryland, Minnesota, New York, North Dakota, Rhode Island, South Dakota Virginia, Washington State and Wisconsin.
[9] The California Franchise Relations Act is at Cal. Bus. & Profs. Code Secs., 20000 et seq.
[10] Cal. Corp. Code Sec. 31220.
[11] *Martini E Ricci Iamino S.P.A. v. Trinity Fruit Sales Co*., 30 F.Supp.3d 954, 966 (E.D.Cal., 2014).
[12] *Id.*
[13] For a description of Ponzi's scheme, see e.g., *Cunningham v. Brown*, 265 U.S. 1 (1924).
[14] See FTC Bus, Guidance Concerning Multi-Level Marke ing, available at *www.ftc.gov/tips-advice/business-center/guidance/business-guidance-concerning-multi-level-marketing*.
[15] See Staff Advisory Opinion -Pyramid Scheme Analysis (Jan. 14, 2014).
[16] See California Seller Assisted Marketing Plan regulation, Cal. Civ. Code Secs., 1812.200 et seq.
[17] See e.g., *Wolf v. Superior Court*, (2004) 114 Cal.App.4th 1343, 1347 (discussing Disney's "agreements with corporate entities such as Kodak, Coca–Cola, and Burger King, licensing them to use Roger Rabbit and Disney characters in their advertising and promotions.").
[18] Federal Petroleum Marketing Practices Act, 15 U.S.C. §§ 2801-2841 (2007).
[19] Cal. Corp. Code Sec. 31104.
[20] See e.g., Cal. Civil Code Sec. 1812.214.

Test No. 130

This self-study activity has been approved for Minimum Continuing Legal Education (MCLE) credit by the San Fernando Valley Bar Association (SFVBA) in the amount of 1 hour. SFVBA certifies that this activity conforms to the standards for approved education activities prescribed by the rules and regulations of the State Bar of California governing minimum continuing legal education.

1. Direct Distribution occurs when one creates a product and sells it.
   ❑ True ❑ False
2. If a credit card is used, the business is not on a cash and carry basis.
   ❑ True ❑ False
3. The Federal Trade Commission regulates Direct Distribution.
   ❑ True ❑ False
4. Under the Independent Wholesale Sales Representatives Contractual Relations Act a wholesaler must have a written agreement with its commission-based sales representatives.
   ❑ True ❑ False
5. A commission-based sales representative can waive the requirements of the act.
   ❑ True ❑ False
6. Many kinds of products are manufactured by one company and sold by another company in the chain of distribution.
   ❑ True ❑ False
7. To be considered a chain, it is necessary to have at least 25 locations.
   ❑ True ❑ False
8. When a supplier provides a marketing program, lets a reseller become strongly associated with the supplier's brand, and charges the reseller a fee, the relationship may be a franchise.
   ❑ True ❑ False
9. Franchising is regulated by the Federal Trade Commission and laws in presale registration and disclosure laws in about 13 states.
   ❑ True ❑ False
10. The Franchise Laws require a franchisor to prepare a Franchise Disclosure Document and present it to the prospective franchisee.
    ❑ True ❑ False
11. A 14-day cooling-off period must elapse before the prospective franchisee can be allowed to sign any agreement or pay any money related to the franchise.
    ❑ True ❑ False
12. About 25 states regulate the ongoing franchise relationship by requiring good cause as a condition for a franchisor to terminate or nonrenew the franchise at the end of its term.
    ❑ True ❑ False
13. Franchisees have no right to form an association over a franchisor's objection.
    ❑ True ❑ False
14. In a consignment, one party provides product to another but title to the property does not change until it is sold.
    ❑ True ❑ False
15. Consignment is a form of agency.
    ❑ True ❑ False
16. Farm produce is often sold based on commission.
    ❑ True ❑ False
17. Multi-level marketing programs can raise suspicion of being unlawful pyramid schemes.
    ❑ True ❑ False
18. Licensing is when the owner of a trademark, trade secret, copyright or patent allows another company to use the property in exchange for a royalty.
    ❑ True ❑ False
19. A patent is a limited monopoly to exclude others from practicing an invention and thus the monopoly benefits the patent holder.
    ❑ True ❑ False
20. Federal and state governments regulate petroleum, beer and wine distribution.
    ❑ True ❑ False

MCLE Answer Sheet No. 130

INSTRUCTIONS:

1. Accurately complete this form.
2. Study the MCLE article in this issue.
3. Answer the test questions by marking the appropriate boxes below.
4. Mail this form and the $20 testing fee for SFVBA members (or $30 for non-SFVBA members) to:

   San Fernando Valley Bar Association
   20750 Ventura Blvd., Suite 140
   Woodland Hills, CA 91364

METHOD OF PAYMENT:

❑ Check or money order payable to "SFVBA"
❑ Please charge my credit card for
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Authorized Signature

5. Make a copy of this completed form for your records.
6. Correct answers and a CLE certificate will be mailed to you within 2 weeks. If you have any questions, please contact our office at (818) 227-0495.

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State/Zip ________________
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State Bar No. ________________

ANSWERS:
Mark your answers by checking the appropriate box. Each question only has one answer.

1.	❑ True	❑ False
2.	❑ True	❑ False
3.	❑ True	❑ False
4.	❑ True	❑ False
5.	❑ True	❑ False
6.	❑ True	❑ False
7.	❑ True	❑ False
8.	❑ True	❑ False
9.	❑ True	❑ False
10.	❑ True	❑ False
11.	❑ True	❑ False
12.	❑ True	❑ False
13.	❑ True	❑ False
14.	❑ True	❑ False
15.	❑ True	❑ False
16.	❑ True	❑ False
17.	❑ True	❑ False
18.	❑ True	❑ False
19.	❑ True	❑ False
20.	❑ True	❑ False