902:Common Issues in Dealing with Sales & Marketing Reps and Distributors

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Faculty Biographies

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Greg Hogenmiller is corporate counsel for Omnium Worldwide, Inc. in Omaha, Nebraska. His responsibilities include providing legal counsel to the organization, advising management and the human resource department on employment related matters, development and implementation of corporate compliance programs including privacy and security initiatives, and managing outside counsel in all facets of litigation.

Mr. Hogenmiller currently serves as legislative chairman for the Nebraska Collectors Association and was recently appointed by the Governor to serve on the Nebraska Collection Agency Licensing Board. He does volunteer work for the local Junior Achievement program and has participated in the local Volunteer Income Tax Assistance program.

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Steven J. Olechny is the vice president, general counsel, and secretary of Microflex Corporation. Microflex Corporation ranks among the most respected exam glove providers in the world, and is the leading supplier of latex and synthetic hand protection to many industries. His responsibilities include corporate secretary, board of directors, international law, international contracts, employment, customs, FDA regulatory, and intellectual property.

Prior to joining the Microflex team, Mr. Olechny was in private practice with Cummings & Lockwood, served as assistant general counsel at United Technologies Corporation, and as deputy general counsel for The Timberland Company.

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UNFAIR COMPETITION AND DECEPTIVE MARKETING

I. Overview of Concepts and Risk Areas

A. Deceptive Marketing (as set forth in the Restatement (Third) of Unfair Competition §§2 through 6 (1995)).

(1) General Principal. One who, in connection with the marketing of goods or services, makes a representation relating to the actor's own goods, services, or commercial activities that is likely to deceive or mislead prospective purchasers to the likely commercial detriment of another . . . is subject to liability to the other.

(a) Commercial Detriment of Another. Liability for false or misleading representations under the general rule cited above depends on a finding that the representation is to the likely commercial detriment of another. A representation is likely to the commercial detriment of another if:

(i) the representation is material, in that it is likely to affect the conduct of prospective purchasers; and

(ii) there is a reasonable basis for believing that the representation has caused or is likely to cause a diversion of trade from the other or harm to the other's reputation or good will.

(b) Misrepresentations Relating to Source: Passing Off. One is subject to liability to another if, in connection with the marketing of goods or services, the actor makes a representation likely to deceive or mislead prospective purchasers by causing the mistaken belief that the actor's business is the business of the other, or that the actor is the agent, affiliate, or associate of the other, or that the goods or services that the actor markets are produced, sponsored, or approved by the other.

(c) Misrepresentations Relating to Source: Reverse Passing Off. One is subject to liability to another if, in marketing goods or services manufactured, produced, or supplied by the other, the actor makes a representation likely to deceive or mislead prospective purchasers by causing the mistaken belief that the actor or a third person is the manufacturer, producer, or supplier of the goods or services if the representation is to the likely commercial detriment of the other.

(d) Misrepresentations in Marketing the Goods or Services of Another. One is subject to liability to another if, in marketing goods or services of which the other is truthfully identified as the manufacturer, producer, or supplier, the actor makes a representation relating to those goods or services that is likely to deceive or mislead prospective purchasers to the likely commercial detriment of the other.

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B. Common Risk Areas

(1) False Advertising

(a) Puffing or Puffery. General statements of praise and references to the advantages of a particular product or service are typically not actionable because buyers do not rely on those statements when making purchasing decisions. Pizza Hut, Inc. v. Papa John's Int'l, Inc., 227 F.3d 489 (5th Cir. 2000). However, specific and measurable claims of product superiority over a competing product may be actionable if purchasers are mislead. Clorox Co. v. Proctor and Gamble, 228 F.3d 24 (1st Cir. 2000).

(b) Comparative advertising. False statements or misrepresentations about the product or services of another that have a likelihood of confusion are actionable. See, U-Haul Int'l, Inc. v. Jartran, Inc., 681 F.2d 1159 (9th Cir. 1982), *aff'd in part, revd in part,* 793 F.2d 1034 (9th Cir. 1982); Skil Corp. v. Rockwell Int'l Corp., 375 F.Supp. 777 (N.D. Ill. 1974).

(c) Survey and Test Results. Misrepresentations about consumer testing or distortion of results to indicate superiority over competing products is actionable. See, Vidal Sassoon, Inc. v. Bristol-Myers Co., 661 F.2d 272 (2nd Cir. 1981); BellSouth Adver. & Publ'g Corp. v. Lambert Publ'g, 45 F.Supp. 1316 (S.D. Ala. 1999), *aff'd without op,* 207 F.3d 663 (11th Cir. 2000).

(d) Sponsorship and Endorsement. False representations or misleading statements indicating that a product or service is sponsored or endorsed by a particular person or organization are actionable. Better Business Bureau, Inc. v. Medical Directors, Inc., 681 F.2d 397 (5th Cir. 1982); Allen v. National Video, Inc., 610 F.Supp. 612 (S.D.N.Y., 1985).

(e) Misrepresentations of Quality. Misleading purchasers through false statements implying a higher quality of product or services than what actually exists is actionable. Cashmere & Camel Hair Mfrs. Inst. v. Saks Fifth Ave., 284 F.3d 302 (1st Cir. 2002); Cargo Safe, Inc. v. Bruest Industries, Inc., 200 USPQ 445 (D. Kan. 1976).

(2) False Designation of Origin

(a) Passing Off or Palming Off. Misrepresentations of source or manufacture can be actionable including passing another's products off as one's own products, commonly referred to as "passing off." False designation of origin claims generally take the form of passing off claims and reverse passing off claims; passing off involves selling of goods or services of one's own creation under the name or mark of another, and reverse passing off occurs when person removes or obliterates original

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trademark, without authorization, before reselling goods produced by someone else. Monotype Corp. v. Simon & Schuster, Inc., 56 USPQ2d 1465 (N.D. Ill. 2000); Archie Comic Publs. V. DeCarlo, 141 F.Supp.2d 428 (S.D. NY 2001).

(b) Geographical origin. Misleading prospective purchasers about the country of origin of a particular product or falsifying the location where products are manufactured is actionable. John Wright, Inc. v. Casper Corp., 419 F.Supp. 292 (E.D. Pa. 1976); Bohsei Enterprises Co. v. Porteous Fastener Co., 441 F.Supp. 162 (C.D. Cal. 1977).

II. Enforcement of Deceptive Marketing Claims

A. Lanham Act (15 U.S.C. §§1051-1127)

(1) Injunctive Relief

(a) Courts have the authority to grant injunctions when necessary to prevent continuing deceptive practices under the Act. 15 U.S.C. §1116. Eastman Kodak Co. v. Royal-Pioneer Paper Box Mfg. Co., 197 F.Supp. 132 (E.D. Pa. 1961); Pantone, Inc. v. A.I. Friedman, Inc., 294 F.Supp. 545 (S.D. NY 1968); Chopra v. Kapur, 185 USPQ 195 (D.C. Cal. 1974).

(b) Injunctive relief is designed to protect both the plaintiff and the general public from deceptive marketing practices and will be granted even in cases where the defendant acted in good faith and no monetary damages are available. Intent is not generally required to obtain injunctive relief. Skil Corp. v. Rockwell Int'l Corp., 375 F.Supp. 777 (N.D. Ill. 1974).

(c) The scope of the injunction will depend on the circumstances of the particular case and the goal of furthering legitimate competition in the marketplace. U-Haul Int'l, Inc. v. Jartran, Inc., 793 F.2d 1034 (9th Cir. 1986); Better Business Bureau, Inc. v. Medical Directors, Inc., 681 F.2d 397 (5th Cir. 1982).

(2) Damages for Pecuniary Losses

(a) Monetary damages are available in actions for deceptive marketing. 15 U.S.C. §1117(a). Metric & Multistandard Components Corp. v. Metric's, Inc., 635 F.2d 710 (8th Cir. 1980).

(b) Damages typically cover lost profits caused by the defendant's deceptive marketing practices, but the injured party must show a causal connection between the defendant's conduct and a specific loss. Hot Wax, Inc. v. Turtle Wax, Inc., 191 F.3d 813 (7th Cir. 1999). A general decline in

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sales or revenue is generally not enough to establish a causal link, but it may be used to create an inference of causation if the market for the effected product or service rose during the same period. Due to the difficulty in proving lost profits, injunctive relief is the most common relief granted in unfair competition cases.

(c) Punitive damages are not available in actions under the Lanham Act, but may be available in unfair competition claims brought under state or common law. U-Haul Int'l, Inc. v. Jartran, Inc., 681 F.2d 1159 (9th Cir. 1982), *aff'd in part, revd in part,* 793 F.2d 1034 (9th Cir. 1982).

(d) The Lanham Act does allow recovery of attorney fees, but only in "exceptional cases" where there is evidence of deliberate action or bad faith prosecution. 15 U.S.C. §1117(b). Ferrero U.S.A., Inc. v. Ozak Trading, Inc., 952 F.2d 44 (3d Cir. 1991); Sealy, Inc. v. Easy Living, Inc., 743 F.2d 1378 (9th Cir. 1984); Scotch Whiskey Assoc. v. Barton Distilling Co., 489 F.2d 809 (7th Cir. 1973).

(3) Recovery of Net Profits

(a) Defendant may be liable for net profits resulting from deceptive marketing practices. ALPO Petfoods, Inc. v. Ralston Purina Co., 913 F.2d 958 (D.C. Cir. 1990).

(b) Compensatory damages and recovery of lost profits may both be obtained in the same case, but double recovery is not allowed. Thus, where profits are derived from the same lost sales claimed as damages, the plaintiff will not be allowed to recover damages and also disgorge the defendant of profits. Friend v. H.A. Friend & Co., 416 F.2d 526 (9th Cir. 1969).

B. State Laws on Deceptive Trade Practices

(1) Uniform Deceptive Trade Practices Act (currently adopted in some form in at least 13 states).

(2) Relation to Federal Law Claims

(a) The Lanham Act does not preempt state causes of action and if damages are available under state law they may be recovered. Sporty's Farm L.L.C. v. Sportsman's Mkt., Inc., 202 F.3d 489 (2nd Cir. 2000).

C. Federal Trade Commission Act (15 U.S.C. §45). The FTC Act prohibits unfair methods of competition. No private right of action exists under the FTC Act although it

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was the model for similar state legislation in some jurisdictions that may provide for private causes of action.

III. Avoiding Liability for Deceptive Marketing

A. Structure of Sales, Business Development and Marketing Groups

(1) Use a cross-functional approach to marketing and business development.

(a) Creates a check and balance mechanism to avoid inadvertent misrepresentations.

(b) Fosters open communication between the front-line operations, manufacturing units, or service providers and the sales and marketing groups charged with describing the end products or service offerings.

(2) Implement procedures that require review of all marketing and advertising materials by the legal department and other functional groups.

(a) Serves as a filter for false statements or misrepresentations;

(b) Ensure that quality or performance based claims are reviewed by the functional groups that will be required to meet the standards.

(c) Allow for verification of statistical information or survey and test results.

(3) Require outside advertising or marketing firms to work with internal functional groups to ensure accuracy of representations.

B. Red Flags for the Legal Department

(1) Puffery of products or services that are specific and measurable as opposed to general and vague claims of superiority or boasting.

(2) Advertising claims that are literally false and likely to be relied upon by prospective customers in making a buying decision.

(3) Sales or marketing techniques that involve direct comparisons with competitors (comparative advertising).

(4) Survey and test results that are misrepresented or are unreasonably exaggerated.

(5) False claims of sponsorship or endorsement by third parties (i.e., celebrities, organizations, etc.)

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(6) Manufacturer or source designations that are false and misleading, or situations where such manufacturers and sources are not adequately disclosed.

(7) Questionable statements or misrepresentations about the quality or content of products and services. Although some puffery is acceptable in advertising and marketing, counsel should be alert for specific, factual statements that are misleading and upon which a customer will rely to make a buying decision.

C. Training Sales and Marketing Staff

(1) Provide relevant sales and marketing staff with a list of risk areas to be avoided and an explanation of the key concepts underlying deceptive marketing claims.

(2) Circulate articles or case summaries from your industry that highlight problematic activity in marketing, advertising and sales. Real life examples will help employees understand the legal concepts and will also send the message that the risks described by the legal department are genuine.

(3) Utilize outside seminars to complement internal training efforts when feasible.

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HOW TO USE POST-EMPLOYMENT RESTRICTIVE COVENANTS TO PROTECT CONFIDENTIAL INFORMATION IN DEALINGS WITH YOUR SALES FORCE

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TYPES OF POST-EMPLOYMENT RESTRICTIVE COVENANTS

- Non-compete
- Non-Solicit
- Non-recruit
- Confidentiality

PRACTICAL STEPS TO PREVENT LITIGATION

- Decide which employees need to sign agreements
    - Limit them to certain employees to prove that you have a legitimate interest that is being protected and to prove that agreements are reasonable
        - Legitimate interest has been described as special facts above and beyond ordinary competition such that an employee would gain an unfair advantage in future competition with the employer in the absence of a non-compete. *Passalacqua v. Naviant*, 844 S.2d 792, (FL App. 2003).
        - Courts will generally find that companies have protectable interests in customer goodwill, trade secrets and customer contacts (especially the employee's work requires the employee to have close contacts with customers, but perhaps not if the clients followed this employee from a prior employer). *See e.g. Safety-Kleen v. Hennkens*, 301 F.3d 931 (8th Cir. 2002) and BDO Seidman v. Hirshberg, 93 NY2d 382 (NY 1999).
        - Reasonableness is judged differently in different states, but for an example, Connecticut listed five criteria by which reasonableness would be measured: length of time; geographic area: the degree of protection given; restrictions on employee's ability to pursue his occupation; and extent of interference with the public's interests. *See NewInno, Inc. v. Peregrim Development, Inc.* 2003 Conn. Super. Lexis 1750 (2003).
        - Reasonableness in geography means the geography has to correspond to the geography in which the employer has business. *Johnston v. Wilkins*, 2003 VT 56 (2003).
        - Another measure of reasonableness is its being limited to restraint that is no greater than that required for the protection of the employer, not imposing an undue hardship on the employee, and not being injurious to the public. *Granzier v. Cabbage, Inc.*, 2003 Ohio 3532 (2003).
        - Even limited time constraints can be held to be unreasonable based on specific circumstances. See e.g. Earthweb v. Schlack, 71 F.Supp.2d 299 (S.D.NY 1999) where a one year non-compete was

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found to be unreasonable when viewed in relation to the information technology industry in the Internet environment.

- Limit them to certain employee to avoid raising the issue of non-enforcement
  - Legal issue is a non-starter, but
  - Practical issue is very real

- Include enough of work force to prove that company has been diligent in protecting trade secrets

- Build hiring process that incorporates the agreements
  - Determine whether applicant is coming with an agreement
  - Make it clear in the OFFER that signing an agreement is a condition of the offer
  - Don't let an employee start working before getting the signed agreement (negotiations have to happen before the start date)
  - If agreements are not consummated prior to start of employment, employee has an argument that the employment is not the consideration for the agreement. *See e.g. National Recruiters Inc. v. Cashman,* 323 N.W.2d 736 (MN 1982); *Midwest Sports Mktg, Inc. v. Hillerich & Bradsby of Can., Ltd.,* 552 N.W.2d 254 (Minn. App. 1996).

- Safeguard Confidential Information during regular course of business
  - Mark information that is confidential (e.g. all computer screens or printouts of client information and prospect lists)
  - Remind employees that information is confidential and that its confidentiality is of great value to the company
  - Put policies and procedures in place to avoid dissemination of secret information beyond those who have a need to know
  - Put signs on copiers reminding employees not to copy confidential information without permission.
  - Have shredders available for confidential destruction of documents containing confidential information.
  - Monitor information that sales reps give to prospects in proposals
    - Make sure sales reps know which information is to be kept confidential
    - Create a procedure for providing confidential information when necessary for a prospect (e.g. must have supervisor approval; must mark &/or package the information separately from public information so that prospect understands the confidentiality and limits disclosure to those with need to know).

- Remind departing employees of their obligations

- Perform an exit interview &/or send a letter to departed employee
    - Provide a copy of the agreement – point out post-employment restrictions and direct the employee to read them carefully

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        - Remind the employee of confidential nature of information to which the employee had access
        - If there seems to be a risk of breach, you might point out measures the company has taken in the past to enforce its rights (this is where a successful action for injunctive relief comes in handy.)
        - Treat employee as fairly and respectfully as possible
            - If you have asked employees to give two-weeks notice and you fire them immediately after they provide this notice, escorting them to the door in front of co-workers, expect them to be disgruntled and to look for ways to seek revenge. While it is sometimes necessary to get the person away from co-workers or clients, see if you can use this period to have the departing employee introduce a replacement or a co-worker to the best clients with an endorsement of the company.
        - Get company materials back
            - Yes, the employee can make copies, but you run the risk of a defense move that you didn't take steps to protect secrets. You also reinforce the message that this information belongs to the company and not to the departing employee
        - Remove the employee's access to the company property. Disable passwords to the company's computer, e-mail and voice mail. Get keys and access cards back.

- When a key employee or high-risk employee leaves, put sales/marketing/customer service into high gear.
    - Understand that money spent here has a higher rate of return and a quicker pay-back than money spent on litigation
    - Start the process of making new connections with the client
        - This saves the business
        - This sends a message to the departed employee that his efforts will be more productive if he directs his attention to new customers rather than to switching your customers.
        - This will alert you early to breaches by a departing employee (Otherwise, you may not realize for months that you are losing customers)
        - This will help you gather evidence to prove your case if you need to do so

POST-PREVENTION/ PRE-LITIGATION

- Send a warning letter to ex-employee
    - Don't exaggerate facts or threatened action
        - Be wary of what your client believes to be the truth
        - Be careful not to set employee up with claims against your client
    - Give the ex-employee a graceful way to back off
        - e.g. ask him or her to inform you if your understanding of the facts is in error

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        - tell the ex-employee that you will consider further action IF you become aware of breaches after this point in time

- Consider sending a warning letter to new employer
    - Put the new employer on notice
        - Notify them if confidential information has been misappropriated. Their use of that information after notice of its having been obtained wrongfully is what will cause them liability
        - Inform them if the employee is in breach of agreement.
    - Be circumspect
        - Don't defame ex-employee
        - Don't tortiously interfere with the new employment relationship
        - Don't be surprised if there are counter-accusations
    - Give the new employer a graceful way to back away.

LITIGATION

- Review the law that applies to your agreement
    - About one third of the United States have statutes dealing with covenants not-to-compete.
        - The following states have statutes prohibiting or severely limiting the use or enforcement of non-competes in employment contexts: Alabama, California, Colorado, Louisiana, North Dakota, Oklahoma, and Texas,
        - The following states have statutes requiring certain conditions for the use or enforcement of non-competes in employment contexts: Georgia, Nevada, North Carolina, Oregon, South Dakota, West Virginia, and Wisconsin.
        - The following states have statutes indicating a public policy to enforce reasonable restrictions on competition by employees. Florida, Hawaii, and Michigan.

    - With or without statutes, courts in different states take very differing views about non-compete agreements. Before spending time on litigation, make sure you know how the courts in the specific jurisdiction look at non-compete agreements. If the prospects look grim, look for the possibility of an alternate venue.

- Determine what facts you can prove & how eager & strong your witnesses will be
    - Are you relying on co-workers of the accused?
    - Will you need the testimony of current customers?
    - Are there documents or other physical evidence?

- Make a realistic assessment of damages and probability of success.
    - Pick the best case – don't assume you have to litigate every case
    - Know that your investment in one case will probably not pay off, but your investment may pay off in preventing further mischief

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- Pick your adversary
  - The ex-employee
  - The ex-employee and the new employer
  - The new employer

- Decide what possible causes of action the employer might have other than breach of contract.
  - Misappropriation of trade secrets
  - Unfair competition
  - Tortious interference with contracts or prospective economic relationships

- Decide whether to seek injunctive relief
  - Injunctive relief may be necessary to prevent irreparable harm, but the courts will generally require the employer to show that there will be less potential harm to the employee if the injunction is granted than to the employer if the injunction is not granted. This will be a difficult test if the employer is seeking to have the court enjoin the former employee from working.
  - By-passing injunctive relief should be considered if the time is too short
    - e.g. if time in agreement is about to expire, cost to get injunction may be too great for its value
    - e.g. if you need discovery to prove facts, you may not be able to come up with the proof necessary in the time needed to get a temporary injunction
  - This is a difficult decision because damages may be very hard to prove.

- Consider creative settlements that will achieve your goals
  - Having a third party compare client lists and agreeing on revenue sharing on "stolen clients"
  - A limited injunction to be entered by the court with the consent of both parties
  - A set of procedures that will govern future hires by new employer
  - Letter from new employer to all of its employees

Conclusion

The procedures you put in place around these agreements will be as important and, in many cases, more important than the words you use in the agreements. Without this "infrastructure", the justice system and the legal department will appear woefully inadequate in protecting your client's business.

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"PRICE DISCRIMINATION" LAW

- Principal Focus of the Robinson-Patman Act:
  - Differential prices to customers who compete with each other.
  - Differential create significant competitive disadvantage.

- Issue:
  - How can you selectively give valued resellers strategic pricing (e.g., discounts, incentives, rebates and allowances)?

PRICE DISCRIMINATION

Elements:

1. Competing customers
2. Charged different prices
3. For goods of like grade and quality
4. Causing competitive injury
5. Without a recognized justification

Recognized Justifications:

- Meeting competition
- Cost-based discounts
- Functional discounts
- Availability of volume discounts

DISCOUNTING

What you can do:

- Discounting is pro-competitive; it is generally perfectly legal.
- Discount to match a competitor's price.
- Discount when the structure of the transaction saves you money.
- Aggregate a distributor's purchases for purpose of qualifying for a particular discount.

When to be careful:

- Offering different prices to similarly situated distributors without a recognized justification.
- Making discounts available to limited numbers of partners.
- Structuring the discount so that it is functionally unavailable to most distributors.

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ENFORCEMENT OF VALUE ADD

What you can do:

- You can and should enforce the value add commitments of its distributors.
- Your contracts should include provisions that allow it to enforce value add:
    - Your audits.
    - Distributor self-reporting.
        - Yearly business plans.
        - Summaries of activities.
    - End-user reports.

When to be careful:

- Discriminatory imposition of value add requirements among similar distributors.
- Discriminatory enforcement of value add provisions.
- Little or no enforcement of requirements.
- Termination because of failure to value add.
- Consistency.
- Documentation.

PROMOTIONS

Promotions should be:

- Non-discriminatory among similarly situated distributors.
- A reasonable time period.
- Supported by business analysis.

Promotions should not be:

- Used an excuse to avoid restrictions on discounting.
- Used to benefit a single distributor at the expense of its competitors.

Discounting Checklist:

1. Is the discount selective, i.e., only offered to certain customers?
2. Are any customers not receiving the discount competing with any who are?
3. Is there a good-faith basis to believe that the lower price is required to meet a competitive offer?
4. Does the price difference reflect actual differences in the cost of supplying the customers?
5. Was the lower price practically available to the higher-paying customer?
6. Is the lower price reasonably related to the functions the customer performs on our behalf?

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