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Distribution Agreements

guide

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1. distribution agreements

Do you need a Distribution Agreement?

A distributor needs a distribution agreement far more than a supplier does. If a distributor is not pressing the supplier for a distribution agreement, in most cases there is no reason for the supplier to press the distributor to sign a distribution agreement. Virtually every issue of concern to a supplier can be resolved without the need of a distribution agreement.

For example:

- Payment terms can be implemented through a credit application and conditions of sale.
- Protection of intellectual property can be achieved through a non-disclosure agreement.
- More than 90% of all trade moves by way of nothing more formal than a purchase order and a confirmation.

Thus, if you are the supplier, and you have just appointed a new distributor, don't jump to the conclusion that you need a distribution agreement. Often, it is advisable to wait and see how the relationship unfolds before you enter into a formal legal contract.

Key Points

- Know your Customer. Even the strongest legal contract will not prevent unethical behaviour. That's why it is so vitally important to know as much as possible about the person with whom you are dealing.
- The importance of due diligence. Try to get references of other suppliers who have distribution agreements with the same customer. Get credit checks and bank references.
- Beware the "Corporate Shell Game." When doing your due diligence, ensure that the name of the company on the legal papers is the same name of the company that you are checking out.
- Get a guarantee. Don't accept assurances that "they" will provide the necessary support and financial backing for a new corporation that is the nominal distributor. Your agreement should be with the company upon which you did the due diligence. If this is not possible, at least get that company to guarantee the performance of the distributor.
- Ask the Distributor for a business plan. Suppose you are not quite sure where to set the performance levels. A good starting point would be to use the numbers in the distributor's own business plan and peg the performance levels at, perhaps, 50% of those numbers.
- Help the Distributor draw up a business plan. If the distributor has no business plan, help them construct one. Give them the top-level issues, and walk them through the process.

2. contract content

- Don't be content with generalisations, ask for specifics.
- Do they plan to use their current marketing resources? If so, how do they plan to allocate them as between your product and others?

- Do they plan to bring in any new marketing resources? If so, what does it take to obtain approval for a capital expenditure?
- Do they plan to take on more staff to handle this programme? If so, how many and what types of staff?

These discussions are part of your due diligence. Just as the distributor will want to conduct a thorough due diligence of your technology, so too will you want to conduct a due diligence to confirm their ability to commercially exploit it.

Once you complete the segment of your discussion on marketing, move on to after-sales service. Each of these topics is vitally important.

Without a good marketing and promotional plan, your product won't sell. Without a good distribution plan, your product won't get stocked.

Learn everything you can about what the distributor proposes to do, then give the information to your lawyer. Your lawyer should include these "to do's" as obligations of the distributor in the distribution agreement.

While not the same as an objective performance measure (e.g. sales per annum), when taken with everything else contained in the agreement, they give leverage against a non-performing distributor and, in the worst case, grounds for termination.

Rights of First Refusal

Sometimes a distributor will demand a "right of first refusal" to new products, new applications or new territories. Such a request may appear benign but it can cause you unnecessary problems.

It is awkward to negotiate with a keen distributor knowing that you will have to present the same terms to another distributor. For this reason, it is better not to grant first right of refusal.

The Products

A distributor may want to seek the rights to all your products. It may not be wise to let this happen - define "products" with great precision. Only give the distributor what they are able to sell with their own resources. Confine the distributor to what they can do best and do not give the distributor all applications of your technology.

The Territory

"Home Turf" Advantage

Every distributor has a "home turf". The distributor knows what their home turf is as do their competitors. Confine the distributor's territory to their home turf and appoint other distributor's in their respective home turfs.

Never grant a territory based upon a distributor's mere expectation of sales there. You can do much better even if you do nothing.

Sub-Distributors

As a general rule, you should not grant the distributor the right to appoint sub-distributors. Only rarely will this be in your best interests. It may sound reasonable on paper but it doesn't usually work out in the real world.

If the distributor needs to appoint sub-distributors, it means that you gave the distributor more territory than they could handle with their own resources. You might as well deal directly with the sub-distributor rather than through a middleman.

If the distributor can't do it, what value are they really adding that you couldn't add yourself? Are they truly in a better position to find a sub-distributor than you are to find a distributor? If a distributor needs the right to appoint sub-distributors so desperately, this should set off alarm bells. The last thing you need is for a middleman to siphon off a margin that would otherwise flow completely to you.

The fact that you may not have another keen party waiting in the wings is beside the point. There is no need to allocate the entire world based upon the one or more persons expressing interest at a given point in time.

Be patient. Allow for the possibility that opportunities might come along in the future. Don't foreclose those opportunities.

Right to Assign

The situation with assignments is similar to that with sub-distribution – it is not in your best interests.

The only exception would be where a distributor undergoes some sort of internal corporate restructuring. Anything more than that, even, a material change in the ownership or control of the distributor, should be deemed a “constructive assignment” requiring your consent, not to be unreasonably withheld.

The same applies where a distributor sells its assets as a going concern. The distribution agreement should not automatically go over to the buyer of the business.

In the case of “permitted” assignments, or if you allow appointments of sub-distributors, make sure that the distributor guarantees and indemnifies you for the acts and omissions of the assignee or sub-distributor, as the case may be.

Hold Back Territory

There is nothing wrong with holding territories in reserve for future allocation. You don't have to parcel out the entire world in a single year.

Exclusivity vs. Non-Exclusivity

Distributors will probably want sole and exclusive rights for a large territory.

If possible, roll out the territory commensurate with the distributor's ability to prove their sales power in a smaller territory.

Let their “earn” exclusivity based upon their performance, measured against certain yardsticks. For example, if the distributor's purchases reach a certain level by a certain time, they can have exclusivity. Remember that it is easier to give than it is to take away.

You may give them exclusivity but provide for the loss of exclusivity if their purchases do not reach a certain level by a certain date.

Beware of the anti-trust implications of confining the sales of a distributor to a specific territory. There are regulations in both the European Union and the United States governing territorial restrictions.

The same goes for parallel imports. It is often hard to stop one distributor from selling into the territory of another distributor. Don't promise more than you can deliver.

In consideration for the exclusive rights granted by the supplier to the distributor, the supplier should be the sole and exclusive supplier of the products.

The distributor should not import, market, distribute or sell any product of a similar design, function or construction to the products of the supplier.

Restraint of Trade

This issue does not usually engender much discussion. If it does, take a step back and ask yourself: "Does this guy have a hidden agenda?"

In exchange for the right to market your product on an exclusive basis, the distributor should surrender any right to market a competitive product. The distributor should also not engage in the parallel development of a competitive product.

Define a "competitive product" with precision. The key elements would be: A product with a similar design; a product with a similar function; a product intended for the same purpose; and a product marketed to the same customer.

If you can incorporate three or four of these elements in your definition of a "competitive product", you will have strong protection. Two elements will give you some protection and one element not enough protection.

The territory of the restraint of trade should be the same as the territory that is the subject of the distribution agreement.

Post-Termination Restraints

The real benefit of a restraint of trade comes into play once the relationship has broken off. After all, it is not likely that a distributor will market a competitive product at the same time that they are marketing your product.

Therefore, make sure that the restraint of trade applies, not only during the term of the distribution agreement, but for a specified time (usually one year) thereafter.

One year may seem like a short time, but in the technology business, it will feel like forever to the distributor. It will discourage the distributor from re-entering the market when the restraint expires. If the distributor does re-enter the market, they will be back to square one.

Even if the distributor is willing to give you an ultra-strong restraint of trade, resist the temptation to accept it. Beware of a Trojan horse. If the term of the restraint is too long, or the territory too expansive, it may be deemed invalid as violating anti-trust policy.

Treaty of Rome Considerations

Watch out for the European Union regulations on territorial restraints:

"Active Sales" means sales made by a distributor pursuant to a comprehensive sales and marketing strategy containing one or more of the following elements, inter alia: advertising; promotion; public relations; a distribution network; service and technical support. The term includes sales that a distributor actively pursues and solicits using its leads and contacts.

"Passive Sales" means sales that do not fall within the definition of "Active Sales". The term would apply to a sale in response to an unsolicited order from a customer whom the distributor neither pursued nor targeted with an active sales strategy.

Free Ramp-Up

Give the distributor a reasonable period to ramp up its programme. Performance measures should not start from date of signature. The distributor needs a grace period to get their programme up and running so you should be reasonable.

You might agree not to appoint another distributor for a certain period, say six or twelve months. This will allow the distributor to get their feet on the ground. They will have a head start against the other distributor.

Competition

Competition can be quite good, particularly in respect to a new product or technology.

The two things that a new product needs most are market awareness and market acceptance. Healthy competition can help expand the market and generate market awareness. Market acceptance is fostered by giving buyers a choice.

Focus groups have borne out the wisdom of creating a “category”, not a “product”. Customers feel more comfortable in their buying decisions by buying from a category of products. They tend to avoid stand alone, orphan, products.

What a technology needs most is respectability. A sole distributor may not be able to achieve respectability for your product.

Competitors will benefit from the market awareness created by each other’s promotional activity. Together, they will establish market acceptance and, with it, respectability.

The more sinister effects of competition are most readily apparent with mature products in mature industries where price becomes paramount. For a new product, however, healthy competition may be just what the product needs to get it off the launch pad.

Admittedly, it is hard to persuade a distributor that competition is good for them. But at least have the discussion. All too often, the discussion never occurs.

Field of Use Restrictions

Consider whether it is appropriate to limit the distributor to a specific class of customer. For example, one distributor may be strong in the do-it-yourself market while another is strong in the professional trade market.

You may appoint two distributors for the same product, if they focus upon different markets.

It is likely that the distributor will not want this; they may seek exclusive rights for all customers in all markets. You will need to find a compromise.

Pricing

Attach a current pricing schedule to the distribution agreement or incorporate it by reference, noting any volume discounts.

It is important to decide what the prices include, for example, freight and taxes.

Remember that price fixing is illegal. You can’t price fix but you can grant “most favoured customer pricing”. These are the prices that a supplier charges their most favoured export customers.

Retail price maintenance is illegal but there is nothing wrong with “suggesting” retail prices. In fact, you can even set your prices as a fixed percentage discount from your suggested retail prices. It doesn’t mean the distributor must sell at the suggested retail prices but a price schedule based upon them has a powerful influence on the distributor’s price-setting discretion.

If you must retain price control, enter into an agency relationship instead of a distribution agreement.

Price changes

The supplier determines price changes, it is not by mutual agreement. It must be in the supplier’s sole and absolute discretion although there may be an obligation to set a commercially reasonable price. Give the distributor 30 days notice of price changes, or longer, with a buy in period.

Some agreements limit the frequency of price changes to not more than once a year. Reasons for price changes may include market conditions, supply conditions, exchange rate fluctuations, changes in the specifications, cost increases and other factors.

Currency

It is important to decide who wears the exchange rate risk. If the supplier does, they should consider forward cover. Allow for a price changes in the event of a currency swing of more than 10%.

Payment Terms

Open account is not unusual anymore, with the growth of international trade and globalisation. Payment used to be a risk but today an overseas supplier is not more disadvantaged than a local supplier. In either case, you will have to engage a lawyer if the customer doesn't pay.

American customers aren't accustomed to letters of credit. Most business is done on open account. They don't mind a credit check, and they will happily give you credit references, but, draw the line at documentary credits.

Your payment terms should be what your competitors' terms are. It's as simple as that. So if your competitor is charging net 30, so should you.

Shipping Terms

All things being equal, customers want landed and delivered stock. They view shipping as the supplier's responsibility. It's your job to get the goods to your customer.

Delivered Duty Paid is the international equivalent of Free Into Store. It means the supplier bears the cost of freight, insurance, Customs duties, entry charges. Risk of loss doesn't pass until the goods are delivered.

Only large corporations may wish to look after their own shipping arrangements.

Incoterms 2000

Incoterms 2000 is published by the International Chamber of Commerce, Paris France.

It covers who pays for freight and insurance, when risk of loss passes, responsibility for clearing the goods through customs, which party pays customs duties, etc.

It is important to specify the shipping terms and the mode of shipment.

Romalpa

There is no Romalpa protection in the US or most of Europe. Title to the goods passes upon delivery.

Another possible arrangement is deposit on order. This is possible if the customer knows that you will have to go to considerable expense.

Ordering Procedure

Initial Order

Will the distributor place an initial order simultaneously with the execution of the Agreement?

Attach an initial order to the Agreement. If that is not practical, make sure that you insert a "drop dead date". That is to say, if the first sale does not occur by an agreed date, either party can terminate the relationship.

How is an order placed?

Review the distributor's standard order form.

If they do not have a standard order form, prepare one and attach it to the agreement. Make sure the order form includes these items:

- Purchase order number
- Date
- Description of products, including any options or accessories
- Quantity
- Price
- Payment details
- Shipping instructions
- Date required by
- Any other instructions
- Signature

Decide what constitutes acceptance of an order by the supplier. Stipulate a time limit between the placement of an order by the distributor and its acceptance by the supplier. Also stipulate the amount of lead-time required between acceptance of an order by the supplier and its shipment.

Stipulate a minimum order size. This is very important when the supplier pays the freight. If the buyer pays the freight, it is somewhat less important. Also stipulate a maximum order size predicated upon existing capacity limitations. Split deliveries and partial shipments should be permitted.

You must set out your order cancellation policy. For example, are purchase orders cancellable?

Brand Ownership

A key decision to make is under what brand will the product be marketed, yours or theirs. Brand ownership is an important issue. The incremental value created by a strong brand will exceed the incremental value created by a weak patent.

If you can, capture that incremental value. In the agreement, include a clause giving you the brand but allowing the distributor to use it during the life of the agreement.

Counter any possible objection of the distributor by explaining how a uniform brand, worldwide, will create greater product awareness. If you use the distributor's brand, you are nothing more than their contract manufacturer.

The cost of registering a brand is inexpensive relative to the cost of registering a patent. Yet the protection afforded by a strong brand cannot be overstated. A strong brand can offset a weak patent; therefore, do not give up the brand without a fight.

Promotion

The distributor should undertake to spend an agreed percentage of sales to advertise and promote the products.

- Trade journal ads
- Trade show exhibits.

To cover the period before meaningful sales eventuate, the clause may state: "The distributor agrees to spend not less than x per cent of sales or y dollars per annum, whichever is greater, to advertise and promote the products."

The distributor should provide proof of such advertising and promotional expenditures to you upon request. If the supplier is to be getting any promotional materials, specify it in the contract. The same applies to the supplier providing any cooperative marketing budget. If so, you must describe your cooperative marketing plan.

It is a good practice to require the distributor to submit an annual marketing plan. It forces the distributor to focus on the market at least once a year.

Performance

Next to price, the issue of performance will probably involve the most discussion during contract negotiations. It can even be a deal breaker. It is important to stand your ground. If the deal falls over because the distributor won't commit to objective performance benchmarks, then it is best to move on. It is not a good idea to allow a distributor to lock you out of a market for several years without agreeing to meet objective performance criteria. It is very difficult to terminate a contract based on a distributor non-performance if the contract contains only subjective performance criteria. Objective performance criteria are essential.

Every distribution agreement must impose objective performance criteria for the distributor to meet. The only exception might be a distribution agreement with a short term, such as one or two years, however short-term distribution agreements are quite rare.

Spell out how many sales (whether in dollars or units) a distributor must make for each year of the agreement.

Some deals allow a distributor to "carry forward" any excess in the minimum performance level. For example, if the minimum performance level is \$1,000,000, and the distributor actually paid \$1,100,000, they would be able to credit the \$100,000 excess against any shortfall in a subsequent year.

Set performance criteria at realistic levels. Don't set the minimum performance levels too high; it is not a sales budget. If anything, set the minimum performance levels so low that the distributor will think to themselves: "Gosh, if I can't achieve that, I wouldn't want to continue with the relationship anyway".

Spell out the consequences of failure to achieve those levels. Usually, failure does not give rise to any liability by the distributor to the supplier. That is to say, if the distributor falls short of the minimum royalty by, say, US\$100,000, that does not mean that they are legally obligated to pay you that sum.

What it does mean is that you may then select from a range of remedies, including formal consultation, reduction in the size of their territory, loss of exclusivity or termination. Performance issues most often arise when there is a near total absence of performance. Rarely do performance issues arise simply because a supplier thinks that the distributor should be able to "do better".

This is because if a distributor is performing to a certain level, you can almost rely upon their rational economic behaviour to ensure that they will seek to maximise their sales and profits.

The problem is in getting the distributor to perform at all, which is where most relationships fall apart. Thus, if a distributor hopes to sell US\$1,000,000 per annum, I would put the minimum performance level at just US\$500,000 per annum, maybe even less. Remember that you are trying to protect yourself against near total non-performance, don't worry about gradations of performance.

Performance levels should mirror the life cycle of the product, they may rise rather steeply over the first three to five years, then level off during the middle five years and gradually decline thereafter. By setting performance levels, a distributor will never be able to "lock up" your technology or put it on ice, and by insisting upon minimum performance levels, it will be impossible for a distributor to lock you out of a market for more than a year at most.

Responsibilities and Obligations

Installation, Commissioning and Training

It is important to spell out the obligations of the supplier and the distributor in terms of installation, commissioning and training.

The distributor should be responsible for installing and commissioning the products at the premises of its customer, assuming that installation and commissioning is required.

The distributor should provide, at the time of commissioning, on-site training to the operators and engineers of its customer.

Such training should cover the use and operation of the products, safety tips, service and maintenance advice and troubleshooting.

The supplier should provide training to the distributor's staff at the supplier's headquarters. The supplier should provide the training at no cost to the distributor. The distributor should bear the travel and accommodation expenses of staff who attend the training session.

The supplier may, in its discretion, provide on-site installation and commissioning services. The supplier may also provide on-site technical support and training to the staff of the distributor or its customer. In the event that the supplier agrees to provide any of these services, the distributor should reimburse the supplier for its reasonable travel and accommodation expenses.

Technical Support

Normally, the distributor provides first level (or front line) support and the supplier provides second level (or back-up) support.

The supplier should:

- Provide such off-site technical support, as the distributor may require
- Provide technical information to assist the distributor in preparing promotional materials.
- Respond to technical questions from the distributor by telephone, fax or email.
- Provide such other technical and analytical information as it has available to support the sale of its products.
- Provide such documentation as would assist the distributor in providing technical support to its customers including operations and maintenance manuals, training manuals, specification sheets and technical information.
- Provide such on-site technical support as the parties may reasonably agree is necessary.

The distributor should reimburse the supplier for reasonable travel and accommodation costs.

Maintenance of Stock and Parts

The distributor should maintain an adequate level of stock and spare parts to service its customers. This level must be defined.

Avoid consignment stock arrangements. The distributor should carry stock, at least a quantity of buffer stock.

Product Localisation

The distributor normally has this responsibility with assistance from the supplier.

Localisation is more than just translating manuals into a foreign language. It would include changes in product labels, manuals and other documentation, converting to metric or some other weights and measures nomenclature, changing the commands of software, the warnings to comply with local requirements, and other aspects.

Warranty

Look at what your competitors offer. Try to get the distributor to respond to warranty claims, and reimburse them for their services. Make sure that they provide substantiation upon request. It is important to see a lawyer when deciding on a warranty. Warranties must really be written by a lawyer who knows the law in the jurisdiction. You can contract out of some warranties, but not all.

Promote Your Capabilities

As a general rule, the more that a supplier must do in the relationship, the greater the consideration they will receive. The more you give, the more you get; therefore, it is incumbent upon you to “dress up” your role in the relationship.

At the very least, you will be providing technical support. That term covers lots of ground. Don't forget to mention everything that you will do in terms of technical support. Don't take anything for granted.

Future Product Developments

Don't forget to mention further research and development that you plan to undertake to support the distributor. It is important to convince the distributor that while generation one is exciting enough, generations two, three and four will be even better.

Try to convince the distributor that you and you alone, have the vision. You can see five and ten years out to where the technology is heading. You have products, either in your head or on the drawing board, to exploit your technology in the future.

Thus, the distributor is buying not only what you have already researched and developed but also a “call” on your vision of the future. If you can impart this excitement to the distributor, you will be able to support a higher level of consideration.

Listen to your customer and take your cues from them. Discover what their needs are and cater to those needs. The more you give, the more you will get.

There are several other areas where you, the supplier, can make an important contribution, such as training, marketing support, trade show attendance and new product development. Each of these may fill a vital need of the distributor.

However, respect the distributor's right to know what is going on. Most distribution agreements fail because the distributor did not fully appreciate what was required to bring the products to market. The number one most common misunderstanding concerns the state of “market readiness” of the product.

It is essential to disclose the products' shortcomings as the distributor may believe that your product is fully developed only to discover that this is not at all the case. The distributor may also underestimate what's required to market the product and may encounter unanticipated delays in start up.

No purpose is served in failing to fully and candidly discuss these issues with the distributor at the outset. If you do not discuss them, you are simply postponing the disappointment and disillusionment that may occur.

The distribution agreement should specifically detail the steps that the distributor needs to take to bring the product to market, or the steps that the supplier needs to take to further develop the product. If further product development is needed, that fact should not be swept under the rug. Quite the opposite, it should be fleshed out in the distribution agreement.

It may be necessary to attach a product development programme to the distribution agreement indicating the specific activities and the relevant milestones for achieving them. Your best defence to a distributor's claim that you misrepresented your technology is: “Don't say I didn't tell you.” So don't hold back, be disarmingly honest about your technology's shortcomings, about

where further product development is required. Detail them in the distribution agreement. Put your cards on the table.

In terms of product development, you know more than the distributor does. It's your brainchild and you know what needs to be done. You know your technology's shortcomings, you know where you ran into difficulty, and you know what you would have done if you had just a little more time and a lot more money.

So when it comes to product development, it is your opportunity to negotiate with superior knowledge. Do not leave the distributor with any doubts as to the direction that your product development will take.

Business Administration

Sales Reports

The distributor should submit quarterly sales reports. To avoid misunderstandings, attach a sales report template to the agreement. In setting up the template, think about how you will use the information provided by the distributor. Is it for market intelligence or to monitor performance?

Whatever your purpose is, make sure that it is known to the distributor beforehand. That is why it is recommended that you annex a form of sales report to the agreement.

Forecasts

This is a must, particularly if the distributor can order ex stock, or if the item is seasonal in nature. The distributor should provide the supplier a rolling twelve month forecast of its anticipated forward requirements updated on a quarterly basis.

Such report should also include details regarding any promotional activity planned by the distributor.

Market Intelligence

The distributor should keep the supplier abreast of important market developments within the Territory including, without limitation:

- Information about competitors, their products and prices.
- Comments on the products by actual and prospective customers.
- Information concerning customer requirements.
- Opportunities for further market development.
- Information about government regulations.
- Market research.
- New products or product enhancements that would be desirable.
- Any other market intelligence.

Compliance with Laws and Regulations

The default situation is that compliance with laws and regulations is your responsibility with one important proviso. The distributor must let you know what the requirements are. The distributor tells you which laws and regulations apply and you, the supplier, must comply with them, if you can.

The supplier must ensure that its products meet or exceed all relevant standards.

- Country of origin marking requirements.
- Product safety standards.

- Electrical certifications (e.g. UL certification).
- Warnings and labelling.
- Registrations and approvals.

The distributor should advise the supplier in what respect any product fails to comply. Nonetheless, the supplier should know the laws and regulations that apply to its products. For information or advice, ring NZTE on 0800 555 888, or contact your NZTE Client Manager.

Insurance

The norm is that each party gets its own insurance.

Sometimes the distributor will insist on being named on the supplier's policy. If the supplier already has products liability insurance in the distributor's territory, the addition of the distributor as a named insured should not be too costly as the risk is already being underwritten.

If the distributor is very keen to represent the supplier, the distributor might include the supplier on the distributor's policy. This is quite rare but does happen.

Disputes

Today, most distribution agreements provide an alternative dispute resolution procedure. The procedure may take many different forms.

If the issue in dispute is capable of a yes or no answer, the parties may appoint an independent "expert" to make the determination. If the dispute involves more complex issues, including issues that are subjective in nature, the parties may employ the services of a professional mediator.

A professional mediator does not have any authority to decide a dispute. They may only cajole, coax and encourage the parties to work out a settlement themselves. However, a professional mediator is a highly skilled problem solver using "tried and true" problem solving methodology. The success rate of a professional mediator is generally quite high so don't underestimate the importance of professional mediation.

If professional mediation fails to resolve the dispute, the agreement may provide for binding arbitration or it may allow either party to pursue its remedies in court.

There are many different arbitration tribunals all over the world: LEADR (NZ); ACDC (Australia); Asia Pacific Centre for the Resolution of International Business Disputes (Asia Pacific Region); International Chamber of Commerce (Worldwide); UNCITRAL (United Nations); American Arbitration Association (United States); SIAC (Singapore); and JATAC (Japan).

Consult your lawyer for advice on a suitable arbitration tribunal.

Governing Law

This can be a very emotive issue. Each party will seek the home court advantage. You will probably lose on this if you are selling into the United States or Europe. You should argue that you are entitled to select the governing law since it is in the distributor's interest that all distributors operate with the same rulebook.

Besides, the New Zealand legal system is highly rated in terms of its fairness, speed and relatively low cost.

If the distributor could choose the governing law, what's to stop other distributors from nominating the law of their countries as the governing law? This would lead to a patchwork quilt of governing laws and present nightmarish conflict of laws issues.

The bottom line is that a uniform governing law for all distributors is in the best interest of each distributor. The only uniform law that should apply would be the law nominated by the supplier.

Fortunately, governing law is not as important as it used to be, thanks to international conventions, the tendency of laws throughout the world to converge around international legal norms and precepts, and most importantly, the use of alternative dispute resolution procedures.

Term of Agreement

From a supplier's perspective, the ideal would be a one-year agreement subject to annual renewal. That's why it is said that a distributor obtains a licence to print money, one year at a time.

Unfortunately, the distributor will give all sorts of arguments why they need a five-year or even ten-year contract. Some of these arguments are valid. They will spend the first couple of years developing the market and they don't want the territory taken away from them.

Just make sure that, with these long-term agreements, you have a clear cut right to terminate for non-performance. By clear-cut, I mean some objective measure of performance as distinct from such subjective measures as "best endeavours" or, worse still, "reasonable endeavours".

Thus, if the distributor does not sell x number of widgets per annum, regardless of the reason, you are able to terminate the contract. If you do not have clear-cut termination rights for non-performance, it could be very difficult to terminate the contract.

If you cannot agree upon objective performance measures, consider a short-term agreement with an option to renew.

Make sure that the agreement spells out the rights and obligations of each party upon termination. The distributor may continue to sell unsold stock for a specified time after the termination date, or you could have an option to buy it back. You should decide whether the supplier has an obligation to buy back unsold stock from the distributor, or only an option to do so at its discretion. Also it is important to decide what price unsold stock will be repurchased.

3. house accounts

You may wish to reserve certain key accounts to whom you will sell direct. These are accounts where the services or support of a distributor are not required. They may also be accounts that pre-date the relationship with the distributor.

4. managing the relationship

How do you manage a relationship?

- Phone the distributor on a regular basis.
- Share with the distributor ideas for market development.
- Tell the distributor about your product development plans and keep them updated.
- Let them know about new developments.

Through this type of communication, the distributor will come to understand the exporter's expectations and will be more inclined to achieve them.

Do not rely upon the legal contract. From an operational point of view, the legal contract has little utility and events will soon overtake it. People don't refer to a legal contract to find out how to sell goods, they refer to a legal contract when a problem arises.

A legal contract is a very poor blueprint for operational details. While it may set out a basic outline, it is up to the parties to sort out the operational details of their relationship.

Listen to your Customer. If at All Possible, Do it Their Way

Do not enter an overseas market with preconceived notions. You must be totally flexible. One distributor may wish to handle the shipping because of particular expertise in that area. Another distributor may have no expertise and may insist that the goods be delivered to their warehouse on a freight paid basis.

The right way of doing business with a distributor is the distributor's way. The distributor is savvy enough to appreciate that everything has a price. Therefore, the supplier should, wherever possible, meet the needs of the distributor and build the cost of doing so into the price of the product.

Have Realistic Expectations

Distributors will sell the products that are the easiest to sell or that earn the best margin. There are some ways that you can discourage this practice but it is practically impossible to eliminate.

The distributor may not share your passion and may not have your product knowledge. They may not have the resources to achieve the full market potential of your product. All of this is simply part and parcel of being a distributor.

There are very few long-term distribution relationships. Usually, it is only a matter of time before a successful supplier will want to have its own staff on the ground, so let the distributor do what it can do best. Your day will come when you can establish a direct presence in the market.

5. conclusion

In this document the fundamental issues that a well drafted distribution agreement should address have been set out.

The distribution agreement need not be more than a few pages in length. Size doesn't matter. Provided it addresses the above issues, it will set the framework for a mutually rewarding, long term, relationship between the supplier and the distributor.

Remember that a distribution agreement is usually an interim relationship. If your business model is sound, you will grow out of this type of relationship sooner than you think and have your own people on the ground.

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