



## DELIVERING STRATEGIC SOLUTIONS ACCA'S 2000 ANNUAL MEETING

### **International Distributorship Agreements: The Four Most Difficult Articles to Negotiate and Draft**

by Delbert E. Winn

Negotiating and drafting an international distributorship agreement can be a fun, challenging, and rewarding experience that draws on all one's legal, business development, sales, marketing, and public relations skills. From the start, counsel deal with adversity in the forms of unfamiliar cultures, unusual business practices, strange languages, different time zones, problematic laws, lost luggage, weird electrical outlets, and telephones that seldom work. Fortunately, both parties to the agreement have the same goal, namely, to establish a profitable relationship. To produce a lasting and workable agreement and relationship, one must anticipate the operational aspects that can and will present problems, address them in negotiations, and discuss potentially contentious areas openly with one's company's prospective business partner and one's counterpart in the negotiations.

In negotiating and drafting an international distribution agreement, the four most difficult issues to resolve during the formation of the relationship are exclusivity, performance and compensation, termination, and winding down. This article addresses how to maneuver through these areas successfully.

#### Exclusivity

Three things in life are certain: death, taxes, and exclusivity requested by international distributors. They have good reason to want it. To make one's own and their companies successful in the territory, they are imparting their name and reputation to another company and contributing their time, facilities, personnel, local licenses, test equipment, business contacts, import duties and other required costs, and additional items that the manufacturer probably has not imagined (but would be glad to list).

When they add value to a product and services by performing pre- and post-warranty service, providing computer software enhancements and customization, acting as a local agent for the collection of certain fees, and purchasing demonstration equipment or systems and warehouse stock, distributors have an even better argument for requesting exclusivity. But in certain extremely large countries, such as India or China, it may be suicidal to grant exclusivity, unless the manufacturer is dealing with a potential distributor with extensive operations throughout the entire country. Even then, cultural and linguistic differences within a country may dictate that a single distributor may not be in the manufacturer's best interests.

Here's a common dilemma: A manufacturing company's management does not want to appoint an exclusive distributor, but its marketing department has chosen a potential distributor who has requested exclusivity. What does counsel do? Try to avoid the use of the terms exclusive and nonexclusive altogether? Unless one ties the distributorship to another relationship, such as a manufacturing joint venture, or the clever counsel can convince the potential distributor that, on the strength of a verbal promise, the company will not appoint another distributor in the territory, the deal may not be successful. If exclusivity is required, there are several arrangements the drafter can use to placate the chosen distributor and convince his or her company to accept

an exclusive relationship with certain limitations and requirements: time limitation, territorial limitation, specific customer limitation, and performance requirements.

### Time Limitation

Time may be a factor if the distributor can gain exclusive rights for a fixed period, such as one year, and thereafter the agreement terminates or converts to a nonexclusive arrangement. Most distributors try to negotiate a maximum amount of time depending on the nature of the products. If they maintain or exceed sales quotas, the drafter may not want to terminate the exclusivity at a fixed date. Instead, an evergreen contract, which renews automatically for another fixed term or on a yearly basis, may be useful. Additionally, the more complex the products and services, such as a telecommunications system or operational control systems, the less advantageous a fixed-termination date may be to both parties.

### Territorial Limitation

Absent the distributor's ability to have extensive exposure to an entire country including its numerous branch offices and repair facilities, one may want to limit exclusivity to a particular area or areas. In this situation, the agreement must define the area and sales that transgress territorial boundaries. Also, as with multiple territories, there may be problems in determining performance from particular or several territories. For example, if a distributor has exclusivity in three territories and has not met annual sales quotas in one, should the agreement convert to nonexclusivity in the deficient territory or in all three?

### Specific Customer Limitation

In countries in which, because of the nature of the product, the manufacturer has few potential customers (such as the country's government or a particular governmental agency), a nonexclusive distributor may accede to earning exclusivity on a customer-by-customer basis. Thus, the drafter must protect his company from numerous claims for discounts or compensation from multiple distributors who have allegedly contacted the same customer first. One solution is to obtain a signed letter on official letterhead from the customer acknowledging that the distributor named has contacted it and stating with whom it is dealing. The distributor agreement should also include a provision that dictates that the first letter received from the potential customer naming a particular distributor guarantees exclusivity. The statement should provide that the sale must be consummated within a set or reasonable amount of time. The provision should also distinguish commissionable or compensatable sales among multiple nonexclusive distributors who have contacted and may be responsible for sales to other divisions or agencies of the same customer.

### Performance Requirements

It is not easy to define a distributor's sales performance necessary to maintain exclusivity. The manufacturer's sales or marketing department can provide guidance by forecasting sales. One must bear in mind that when distributors take on a new product, they are risking their reputation and money on the success of a product. As a general rule, the more complex the product, the more reasonable the sales requirement should be, at least during a ramp-up period. Furthermore, the manufacturer may need to evaluate the economic climate in the particular country and any adverse changes thereto that may affect the buying power of the distributor's customers, including currency devaluations and high unemployment.

At a minimum, a performance-dependent agreement should provide the conditions that trigger credit for a sale. These terms may include the following parameters: crediting an order against a sales quota only after the company receives all or a portion of the monies; apportioning sales credit when more than one distributor or party is involved; not crediting sales in excess of those required in a single year toward sales for the following year or term; counting toward the distributor's sales credit any of the company's direct sales acquired through a distributor's lead; and crediting toward the performance quota sales generated by third parties, possibly

including one's own company, without the assistance of the distributor.

A distributorship agreement structured for exclusivity imposes obligations on both parties. Thus, drafters should be aware of several items, including dual exclusivity, manufacturer's exceptions, distributor's exceptions, shared commissions and discounts, and warranties.

### Dual Exclusivity

Dual (or reciprocal) exclusivity deems that the manufacturer will not engage in sales activities in the distributor's exclusive territory or independently solicit customers exclusive to another distributor in the territory, if specific customer exclusivity has been granted. This restriction is subject to possible exceptions. Moreover, the distributor agrees not to sell or resell similar products or services of other manufacturers (competitors with products similar in form, fit, and function) in the territory or elsewhere or to sell knowingly the manufacturer's products outside the territory. The manufacturer thereby relinquishes the right to act as it would elsewhere on its own behalf.

The restrictions placed on the distributor should, a fortiori, extend to activities such as manufacturing by the distributor (including software duplication other than required by the distributorship agreement). They may also apply to the use of offices, depots, warehouses, and service facilities owned or controlled by the distributor outside the territory that were established after negotiations commenced for the distributor agreement or existed prior thereto and may compete with the manufacturer's products and services outside the territory. Additionally, the agreement should prohibit the distributor from seeking customers outside the territory or selling to parties in the territory that it knows or should have known will sell the products outside the territory; this restriction includes prohibiting the distributor's ability to sell outside the territory through the internet.

### Manufacturer's Exceptions

In some cases the manufacturer will want the right to sell directly or indirectly into the distributor's exclusive territory. Such instances include, but are not limited to,

- a customer who refuses to purchase the manufacturer's products from the distributor;
- a customer to whom the distributor may be prohibited from selling by law or due to prior contractual arrangements;
- products purchased in the United States and installed at overseas government or military establishments;
- products purchased in the United States by U.S. corporations for installation in their own or partner's facilities in the distributor's territory;
- products purchased in the United States by third parties and incorporated in their own manufactured products and contemplated to be sold or installed in the distributor's territory;
- internet originated sales; and,
- products purchased outside the United States (but not in the distributor's exclusive territory) that are incorporated by the purchaser into its own products and subsequently sold in the distributor's exclusive territory.

Whether the distributor is entitled to a commission on such sales is a matter of negotiation. The entitlement depends largely on which services the distributor provides to the ultimate customer and whether the

distributor has been responsible for obtaining requisite governmental approval for the product's sale in the territory.<sup>1</sup>

### Distributor's Exceptions

Just as a manufacturer may reserve the right to sell into the exclusive territory, an exclusive distributor may want to retain the same rights to sell to a multinational company, headquartered or located in its exclusive territory, that can ship the manufacturer's products out of the territory as a component or stand-alone product for use in its worldwide facilities. For example, an exclusive distributor in Indonesia may sell the manufacturer's products to an Indonesian conglomerate that sends the product to its facility in Japan, where the manufacturer has appointed a Japanese company as its exclusive distributor.

In either case, if such activity is contemplated and permitted, the agreement should be clear that it would not constitute a breach of the agreement's dual exclusivity commitment on either the manufacturer's or distributor's part, provided that it is not done with the intent to obviate the spirit and terms<sup>2</sup> of the distribution agreement.

To protect the manufacturer from the distributor's violative intent or conduct, the agreement should list specific examples of suspect activity; these may include the establishment of a sales network (dealers, agents, and so on) outside the territory that is rewarded for sales of the company's products or the distributor's placing the products in catalogues of third<sup>3</sup> parties (including websites) outside the territory where a sales incentive is given. If the distributor is permitted to sell outside the territory via multinational companies located in the territory, the distributor should be made responsible for the required services normally performed in the territory (installation, maintenance, pre- and post-warranty service, customization, and so on) to the satisfaction of the manufacturer. Additionally, if the distributor has obtained any product-specific governmental approvals in its name for sales in the territory (for example, radio frequency or item type approval), it should be obligated to lend such approval or authorization to the manufacturer in its sales in the territory made through one or more enumerated exceptions.

### Shared Commissions and Discounts

In the event that a manufacturer's products become components of third parties' products and such products end up in the distributor's exclusive territory through third parties' sales efforts, the<sup>4</sup> distributor does not normally receive a commission on the sale. In such instances, the seller or the purchaser usually contracts directly with the distributor for any required ancillary services. If the distributor is not contracted to provide such required services, the manufacturer should consider not selling or shipping the products into the territory unless the purchaser agrees that the manufacturer and the distributor have no liability for nonperformance of the products. The manufacturer may also want to receive compensation (time, material, and expenses) for providing the required services by itself or by subcontracting with the distributor or a third party.

If the distributor will receive a commission on the manufacturer's or third party's sales into the territory, a reasonable apportionment may be required, if for no reason other than to limit the manufacturer's exposure to pay multiple commissions. The commission, for example, could be apportioned in thirds:

- the distributor in whose territory the purchase order was placed (assuming the distributor was responsible for the order);
- the distributor in whose territory the product is delivered and where services (installation, maintenance, pre- and post-warranty service, customization, and so on) are performed by the distributor; and either
- the first two distributors, apportioned in the sole discretion of the manufacturer, based on the efforts

of each to consummate the sale; or

- a third party who was equally responsible for the sale by means of referral or design.

The apportioning of the commission or discount presupposes that the manufacturer has standardized and published its commission scale so that all parties know in advance their entitlements. Likewise, the manufacturer should reserve the right to make any proportional commission splits at its own, final discretion.

## Warranties

The restrictions placed on the exclusive distributor noted above should be drafted in the agreement as warranties or conditions of exclusivity. If these are breached or uncorrected within a specified time, they will give the manufacturer the option to terminate the distributorship agreement or convert the agreement to a nonexclusive arrangement.

## Performance Criteria and Compensation

Once the manufacturer has found an international distributor and addressed and overcome the exclusivity issue, there should be a clear understanding of the distributor's performance expectations and compensation.

### Performance Criteria

A performance clause should set forth annual sales objectives in the body of the agreement or an exhibit. It should also state that the distributor must meet yearly (or other agreed-upon term) sales objectives, or the agreement's termination clause can provide for termination or conversion to a nonexclusive arrangement if the distributor fails to meet sales objectives. By attaching an exhibit, periodic revisions can be made by merely supplying the distributor with a revision; this assumes that the manufacturer has reserved the right to make periodic changes to the exhibit upon specific advance notice. The alternative is a more tedious amendment of the distributor agreement itself.

The agreement should also state when the contract goes into effect, such as the beginning of the year or other period used. For example, this could be from the date of the agreement, on a calendar basis, or from another date (such as the date of equipment or radio frequency approval in the territory or any required governmental approval of the distributorship agreement itself).

In establishing performance goals, the manufacturer can predetermine performance criteria, the manufacturer and distributor can mutually agree upon them in a business plan, and/or the distributor can supply projected sales figures initially or periodically. If they are unable to concur on criteria, the agreement should provide one of the three options: the manufacturer will be free to set the next annual sales quota; the next year's sales will be a percentage increase of the previous year's sales; or the next year's sales will be a percentage above the average sales for several previous years. If at all possible, one should avoid using words such as endeavor or best efforts in the distributor's obligation to meet sales objectives, because the operative definition of each will be construed differently by the manufacturer and the distributor; that is, the manufacturer will deem it a condition precedent and the distributor a good faith effort. Having established a sales figure, the manufacturer must delineate what precisely the distributor must do to meet the figure.

### Sales Quotas

In drafting the agreement, the manufacturer must take care to note whether sales quotas are calculated on the distributor's annual revenues (in U.S. dollars) or the manufacturer's net payments (after discount or commission). These same figures factor into determining the distributor's incentives.

If the distribution agreement covers multiple territories, sales quotas can be established in several ways. One

option is to provide that the distributor can maintain exclusivity if it reaches sales quota in each territory. Or it may retain exclusivity even if it does not meet sales objectives in one or more territories covered by the agreement but does achieve a total sales objective in all territories. Alternatively, the manufacturer may want to terminate exclusivity or convert to nonexclusivity for any territory in which the objective is not met, with exclusivity maintained for the remainder.

Distributor's orders submitted should only be valid when they are accepted in writing by the manufacturer, submitted on the manufacturer's own purchase order form without change, or submitted on an order form approved by the manufacturer. The orders should not count toward the annual sales quota until the manufacturer receives the entire purchase price in U.S. dollars or agreed-upon currency. Once the distributor receives payment, the manufacturer should provide for certain adjustments that will affect the quota. Distributors should not be credited for a sale against their quota if a customer later returns a product.<sup>2</sup>

In determining whether a sales quota has been met, the manufacturer should take into consideration matters outside the distributor's control. Factors that may come into play include availability of the manufacturer's products; changes in local laws; out of box failure (OBF); penalty or liquidated-damage provisions that either the distributor or the manufacturer has accepted to make the sale to the customer;<sup>3</sup> extraordinarily large orders in which payment flows directly to the manufacturer from the customer instead of from the distributor; competition that may cause a lower price, discount, or commission; the distributor's taking an extraordinarily large risk in making or financing the sale; and product discount rates limited by the customer (for example, government contracts).

One method of establishing a quota for a new distributor in a previously untested territory (or territories) is to set a reasonable target for sales over a period of years. For example, if the period established is four years, to maintain exclusivity the distributor would have to maintain certain percentages of the quota established in a territory, or in each territory if multiple territories are involved. Because excessive time and effort are required in establishing a new product in a territory, in the first year the distributor may be required to sell 10 percent of quota, 25 percent for the second year, 60 percent for the third year, and 100 percent for the fourth year.

## Compensation

Often distributors who sell noncompetitive products have compensation plans in place. By definition (or at least common practice) the distributor purchases the manufacturer's product at a discount below list price or manufacturer's recommended selling price, assumes the risk of its customer's failure to pay, and is free to establish its own resale price in the territory. But there may be instances in which, to establish a uniform pricing structure in a particular territory or territories, the manufacturer wants to keep the price to the end-user consistent, without running afoul of any applicable antitrust regulations or any favored nation contract provisions that it has with other distributors.<sup>4</sup> Depending on the particular situation in the territory, the manufacturer should establish either a discount structure (fixed or variable) or a commission on sales equivalent to the discount structure. If any sales in the territory are excluded from the distributor (that is, reserved for the manufacturer under one or more of the manufacturer's exceptions noted above), they should be excluded from sales quota credit. Alternatively, if any split commissions occur, they should be credited toward the entitled distributor's annual sales quota only if the distributor is performing required customer services (installation, maintenance, pre- and post-warranty service, customization, and so on).

## Sales Incentives

Discount schedules should be structured to incite the distributor to sell the products to its customers; purchase products for demonstration and customer training; and maintain adequate inventory of popular products, spares, and repair parts. Although discount structures are multiple, both the distributor and manufacturer need to understand easily the distributor's requirements, fulfillment of the requirements, and any discounts.

Distributors' rewards should be based on a combination of revenue level, product category, training and certification, and distributor-unique discounts. A sample discount schedule appears in the sidebar on page 48.

## Termination

Anytime a new relationship is entered into such as a distribution arrangement, both parties have high expectations. And why not? Much time, effort, and expense has preceded their arrival at the negotiating table. Thus, one of the hardest things to accept in the negotiation process is that the relationship may not work. Drafters of international distribution agreements have one opportunity to protect their manufacturer, that is, during the negotiation and drafting of the agreement. For these reasons, a termination clause should address the following areas:

### Termination by Either Party without Cause

Typically such a provision provides that either party can terminate the agreement without cause by giving a specified number of days or months of prior notice. The manufacturer wants the ability to terminate at will as a protection, and the distributor does not want this restriction because of its numerous contributions, such as reputation, time, investment, and so on. The distributor especially opposes the limitation if the relationship has been successful and if the agreement contains a noncompete clause that survives termination. The distributor will most likely refuse to accept such a provision claiming that it can always be terminated for breaching the agreement. The manufacturer's lawyer has an obligation to his or her client to attempt to introduce the clause into the draft, and the distributor's lawyer to attempt to have it removed. But it can't hurt to ask and sometimes the distributor will accept such a provision because of a possible quick, one-time, yet highly profitable yield. The manufacturer can use removal as leverage for other agreement concessions.

### Termination by Manufacturer for Uncorrected Breach

Termination for an uncorrected breach applies to violations of specific terms, conditions, obligations, and warranties enumerated in the agreement. Actions that fall under this category include failure to meet enumerated sales requirements or quotas, aggressively promote products, maintain adequate stock and spare levels, permit the manufacturer to inspect sales and inventory records, and pay the manufacturer in a timely fashion.

In such cases, termination should be automatic and without further notice required to the distributor if the violative conduct is not remedied to the manufacturer's satisfaction within a specified number of days (for example, 30 or 60) after the violator has received written notice. As a practical matter, however, notice of the termination must be given to the distributor to commence the winding down of its activities in the territory. In drafting the distribution agreement, one must carefully define what constitutes a correction or remedy and when notice is effective to trigger the clock.

### Immediate Termination by Manufacturer for Distributor's Egregious Conduct

Drafters should also list specifically conduct sufficient for the manufacturer to immediately terminate the agreement without the distributor's ability to cure the action or failure to act. Examples of inappropriate conduct include violating the noncompete or confidentiality provision, making false or misleading statements or representations to the manufacturer or third parties, attempting or making actual assignment or sale of distributor's rights and obligations without the manufacturer's prior written consent, attempting or making actual reversal of the engineering of manufacturer's software product, selling an interest in the distributor's company to a competitor of the manufacturer, violating exclusivity restrictions, and engaging in any conduct that would subject the manufacturer to liability.<sup>5</sup> Other conduct unique to one's industry that would warrant immediate termination should also be articulated.

### Immediate Termination for Reasons beyond the Control of Either Party

The manufacturer should retain the right to immediately terminate the agreement if the distributor becomes subject to involuntary bankruptcy, receivership, or other involuntary proceedings; either party is nationalized or has its material assets expropriated; the distributor or manufacturer fails to obtain a required governmental license or approval; the distributor loses a required governmental license or approval; or the distributor, if an individual, dies.

### Immediate Termination for Reasons within the Control of Either Party

Falling within this category are the distributor's voluntary filing for bankruptcy or receivership, making an assignment for the benefit of its creditors, and the distributor's acquisition by a party whom the manufacturer deems a competitor. Likewise, should the manufacturer voluntarily file for bankruptcy or receivership or make an assignment for its creditors' benefit, the distributor may want the same termination right.

### Optional Termination by Manufacturer for Enumerated Causes

Typically a provision allowing optional termination, with 30 or 60 days' notice, will list actions, inactions, or conditions that directly affect the manufacturer's involvement in the relationship and have little or no possibility for either party to correct. Such causes for termination include a material change<sup>6</sup> of the distributor's management, ownership, control, sales personnel, sales and marketing capability, or financial condition; change of territory's government or financial stability that the manufacturer deems adversely affects the distributor's ability to sell products;<sup>7</sup> or the adoption of any territorial law or regulation that would restrict the manufacturer's termination rights or invalidate any material provisions of the distribution agreement.

### Optional Termination by Distributor for Enumerated Causes

Such causes for termination include a product's technical difficulties or limitations that the manufacturer does not remedy in a timely manner and a product's failure to conform to governmental code or regulation. When a product is introduced in the territory, the distributor may also desire to retain the right to terminate the agreement if potential customers do not accept the pilot installation or the products themselves.

### Mutual Termination

If both the manufacturer and the distributor agree to terminate the agreement for whatever reasons, the termination should only be effective when both parties execute a memorandum for mutual termination.

### Failure to Terminate

The manufacturer should provide that its failure to terminate when such right exists would not constitute a condonation or waiver of subsequent breaches. Termination should be in addition to, not in lieu of, other legal rights and remedies.

### Winding Down

More often than not, international distributorship agreements do not address each party's expected actions upon termination or the effects on the distributor's (now manufacturer's) customers when their vendor no longer sells or maintains the product. The manufacturer has a vested interest in ensuring an orderly transition to a new distributor or service provider because, similar to the distributor's arguments for exclusivity, the manufacturer now has a reputation to protect and a product to service in the territory, not to mention more product to sell. Likewise, upon a termination, the distributor wishes to retain its reputation and possibly the same customers with whom it dealt on the manufacturer's behalf.



If the manufacturer has a good relationship with its international distributor, assumes the transition to another distributor (or to the manufacturer taking over the obligations of the former distributor) will be smooth, and believes in the tooth fairy, it may consider a provision in the agreement as simple as the following, which appeared in an actual agreement:

In connection with a termination of this agreement, manufacturer and distributor shall cooperate in good faith so that distributor may honor its commitments to its customers made in accordance with the provisions of this agreement for the remainder of the terms of such agreements distributor may have entered into with its customers, provided distributor's undertakings in such contracts are not exceeding normal business practice.

A more pragmatic drafter may want to incorporate a structured transition article covering the following major areas.

#### Cessation of Rights and Sales Activities

Upon termination, all sales and other activities in the territory conducted by the distributor to further the distributorship should terminate, except continuation of agreed-upon services such as maintenance and warranty work.

#### Settlement of Open Accounts

The distributor should be obligated to settle immediately any indebtedness to the manufacturer without the manufacturer having to make a demand, give formal notice, or give a default notice. Additionally, the distributor should not have to be granted time to cure its nonpayment or the ability to invoke any arbitration clause. The manufacturer should also be entitled to all reasonable legal fees<sup>68</sup> it incurs in negotiating or collecting the debt and enforcing the distribution agreement.

#### Cessation of Use and Return of Confidential Information, Documentation, and Intellectual Property

The distributor should be required to stop using and return all of the manufacturer's confidential information, and it should certify in writing to such cessation. It should also cease using any of the manufacturer's trademarks, trade names, logo designs, and the like and anything used by the distributor that appears then or thereafter as confusingly similar. At its expense, the distributor should also turn over to the manufacturer any generated customer and mailing lists (to the extent not necessary to continue agreed services); return all advertising media and marketing materials relating to manufacturer or the distribution relationship; delete any references to the manufacturer on its website;<sup>8</sup> delete any references to the manufacturer<sup>9</sup> in its support documentation, instruction books, and operating manuals;<sup>9</sup> return to the manufacturer or destroy all the manufacturer's software (source and object code); and give the manufacturer any modifications, enhancements, foreign language translations, screen commands, derivatives, and other alterations that it made or developed.

#### Continuation of Certain Licenses

If the distributor has authorization to make customer-requested improvements to the products (especially software products) or has developed ancillary programs for the products, the agreement should provide that not only does the manufacturer receive<sup>10</sup> the source and object code for the improvements and ancillary products, but that the manufacturer should also receive all rights to the software.<sup>10</sup> If the manufacturer only negotiated a license to use such programs or improvements outside the territory,<sup>11</sup> it may have to agree to give the distributor, who made the improvements or developed the ancillary programs at its own expense, a royalty or other suitable compensation for continued use of the improvement and ancillary programs both inside and outside the territory.

## Assignment of All Licenses, Contracts, and Accounts

Upon termination of the distribution agreement, all software and other licenses granted to the distributor that are unnecessary for continuing the agreed-upon services should be terminated.<sup>12</sup> Often, after giving the required prior notice of termination, the manufacturer does not have sufficient time to find, equip, and train a substitute distributor. This disruption leaves the manufacturer with three choices regarding the customers who have purchased the products: provide the maintenance and warranty work itself, find another company to provide the services, or allow the former distributor to continue providing the required services. In the last scenario, the former distributor needs assurances of availability of parts, technical information, the manufacturer's assistance, and remuneration for warranty work at commercially reasonable prices for a specified period of time.<sup>13</sup> It will also need to be able to contract with the customer for continued maintenance service and post-warranty work. If the former distributor assigns maintenance and similar contracts to the manufacturer or a third party at the manufacturer's request, it often wants a commission on resulting future revenues.<sup>14</sup>

## Completion of Pending Orders

When the agreement terminates, the manufacturer may have accepted but not fulfilled pending or outstanding orders, or it may be unaware of orders taken by the distributor. Therefore, the agreement should require the distributor to give the manufacturer a detailed list of the current sales activities, negotiations, and status. Then the manufacturer can either complete the orders itself, permit a third party or new distributor to do so, or allow the former distributor to finalize any sales. For this last option, the manufacturer should allow the former distributor to complete the orders as if the agreement were still in force. The manufacturer should pay or apportion (if more than one party is credited with the sale) any third-party commissions. Should the former distributor be responsible for any new sales, possibly from a customer unaware that the distribution relationship has terminated, the agreement may provide that <sup>15</sup>the former distributor gains a commission at the manufacturer's discretion and proportional to the former distributor's participation in the sale.

The agreement should stipulate responsibility for installation and maintenance of the product. To guarantee a possibly disgruntled former distributor's payment, the manufacturer should have made the order settlement after the termination (or during the termination notice period) and prior to shipment in cash or by letter of credit. If the manufacturer has allowed the distributor to purchase on credit, the manufacturer may want to limit orders after the termination notice has been given or switch to a cash or letter of credit form of payment.

## Disposition of Inventory

If at termination the distributor holds inventory, several options are available to both parties. The distributor can be allowed to sell the remaining inventory under the distribution agreement's conditions with no repurchase obligation on the manufacturer's part. Alternatively, the manufacturer can exercise a previously granted option to purchase the remaining inventory at a predetermined price.<sup>15</sup>

The manufacturer should also retain the right to inspect and list the products destined for repurchase and to reject or adjust the price downward for any products that are shopworn, incomplete, obsolete, outdated, or in other unacceptable conditions. For any returned inventory, the party designated in the distribution agreement pays all packing, insurance, freight charges, and other related costs. A compromise may allow the distributor to sell and retain all proceeds from products in inventory at termination. It may also permit the manufacturer to purchase all unsold or unused spare parts and components remaining after a specified time.

## Cancellation of Government Registrations and Assignment of Approvals

Some countries require registration of the distributorship agreement, or a memorandum thereof, as well as approvals to sell and use certain products in a particular country.<sup>16</sup> If a distribution agreement is terminated,

the distributor should have to file notice of the termination and transfer any acquired approvals to the manufacturer or successor distributor. Ideally, the manufacturer would like to have the approval or license in its own name. But if it is not a resident of the country, it may be prohibited from owning the approval or license; in this case, the former distributor should be obligated to execute any required documentation to transfer the approvals or licenses to the distributor's successor, or it should attempt to transfer the approval to the manufacturer.<sup>17</sup>

### Termination Compensation

Some countries provide for compensation to the representative upon termination. This may encompass monetary payments to sales agents terminated with or without cause, because the agent improved the good name and business of the manufacturer at the agent's risk and expense. Those same countries also provide for similar compensation to distributors under certain conditions, but the manufacturer can usually avoid this type of indemnity if it terminates the agreement with sufficient advance notice to the distributor and with legitimate reason. To avoid any unnecessary payments to distributors at termination, the manufacturer should seek the advice of local counsel in the territory.

### Cancellation Indemnity

Most distributor agreements include indemnity clauses in which the distributor (and often the manufacturer, too) indemnifies the manufacturer against losses, damages, and expenses of any form, kind or nature for negligence, other tortious conduct, breach of covenants, violation of laws, regulations, false statements, taxes, duties, and so on. Agreements should also contain a termination indemnification. By this the distributor indemnifies the manufacturer upon termination from all costs, expenses, liabilities, and damages related to the actual termination or nonrenewal; it also specifically denies any liability on the manufacturer's part for any punitive, special, incidental, or consequential damages.<sup>18</sup> The provision should also include a declaration that the manufacturer made no statements or representations about the length or perpetuation of the distributorship relationship or any guarantee that the distributor would realize profit from it. It should also state that, in executing the agreement, the distributor was aware of the inherent risk involved and executed the agreement only after receiving the advice of its local legal counsel.

### From Form to Function

In any agreement, the drafter can try to cover all matters that will be encountered and cover all the problems that may arise. We all know this is impossible. Asking a foreign lawyer to draft your distribution agreement is tantamount to a "lawyer's relief project" often taking weeks or months while the billing clock is running. Knowing what issues will be the most critical to both parties, discussing them in the open and agreeing on how the relationship will proceed and end is an important step in establishing a lasting, working, and problem-free relationship. Preparing a draft of an agreement in advance that can be discussed with the distributor and reviewed and revised by your local counsel in the territory will save you and your company time, money, and grief.

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### Notes

1. These services may include installation, maintenance, pre- and post-warranty service, software and hardware customization, acting as the manufacturer's agent for receipt of customers' payments (for example, for software sublicenses), making application(s) for government approval(s) in the territory, and so on.
2. Exceptions to this rule are two: if the distributor has paid for the product and includes the

return in its inventory or a paid order is later cancelled.

3. If the distributor agrees with its customer to assume a monetary penalty if the manufacturer fails to timely deliver the product, it may deserve leniency in quota determination.

4. For information on antitrust regulations, see Diane P. Wood, *The Antitrust Aspects of International Commercial Transactions in Negotiating and Structuring International Commercial Transactions: Legal Analysis with Sample Agreements*, A.B.A. Sec. Pub. Int. L. & Prac. (1991).

5. E.g., violation of the U.S. Foreign Corrupt Practices Act, 15 U.S.C §78dd-1(a), 15 U.S.C §78dd-2(a).

6. Drafters should define material and/or list examples.

7. E.g., a severe currency devaluation.

8. Deleting references includes removing copies of the manufacturer's materials (technical descriptions, and so on) and disabling any links to the manufacturer's website appearing in the distributor's website.

9. The distributor should return hard copies of these materials to the manufacturer (unless needed for continuing customer maintenance or warranty work), or it should destroy them.

10. This parameter includes rights in the territory for its continuing use or the use of the next distributor.

11. This is usually a worldwide, royalty-free, exclusive license.

12. E.g., maintenance and warranty work

13. E.g., Five years is usually sufficient.

14. From 5 to 10 percent of the value to the service provider (only when received) may be reasonable.

15. I.e., manufacturer's list price less any discounts granted to the distributor, equal to that paid by the distributor, or the fair market value on the date of termination. Otherwise the parties could negotiate in good faith to determine such value, or, assuming the parties can not agree on a fair price, they could use the invoice price to the distributor less a percentage, for example, 20 percent per year or portion thereof, from the date of the original invoice.

16. E.g., a product operating at certain frequencies and power levels.

17. If the transfer fails, the former distributor should hold such approval for the benefit and use of the manufacturer or its designee.

18. The damage exclusion should include lost profits and any other type of losses not provided for specifically in the agreement that the former distributor may incur.

### **Winn first box:**

International Travel Tips:

Only a seasoned international traveler would think of the tips listed below, resulting from actual experiences such as a destroyed notebook computer screen that was smashed by a baggage claim luggage cart to the stripped hot water shower knob that came off 20 minutes before an important breakfast meeting in a "five star" hotel in New Delhi.

1. Take an extra, collapsible, sturdy nylon duffel or sports bag and pack it flat in the bottom of your suitcase. When you purchase gifts or souvenirs or acquire other unique paraphernalia from your trip, you can protect your purchases in your suitcase by displacing their volume into the collapsible bag with undergarments, shoes and the like, which you will not need on the trip home. A baggage checked duffel or sports bag gets less or no attention from customs officials. Try checking a cardboard box filled with the same materials and see if it is questioned.
2. If you travel with a notebook computer in a soft carryon case, place the computer in a protective foam sleeve (available at most luggage stores) and put a legal-size clip board (available at stationary or office supply stores) – with the clip and mechanism removed between the computer and the outside of the soft case. Because the clipboard is light and thin, it will protect the computer from costly repair from accidental impact with luggage carts, airline seat armrests, and the like.
3. Pack in your suitcase small needle-nose pliers (available at hardware or home improvement stores) or a folding mini-tool that contains needle-nose pliers. The pliers weigh almost nothing and are invaluable for fixing bent luggage clasps and eyeglasses and even turning on the bathroom shower when the hot water knob falls off just as you are stepping in the shower before an important early morning meeting. You can control the temperature with the cold water faucet knob.
4. If your international hotel charges a small fortune per page for printing a draft of a long document from your notebook or diskette, fax the document from your computer to the hotel's fax number from your room (usually a local free call). If the hotel does not charge to receive faxes (most do not), you have a free draft to review delivered right to your room.
5. Don't forget to take extra camera batteries. Film can be purchased worldwide, but not batteries. Your camera will invariably need a battery when none are available in your host country. Make sure you have the right kind and enough batteries. Some cameras use more than one battery and some flash attachments use a different battery type than the camera. Take an extra camera as an additional precaution.
6. Take photocopies of credit cards, airline and hotel points cards, and your passport. Carry the copies separately from your wallet, as they will come in handy in the event the originals are lost and can save on space and weight. Copies of prescriptions, for example eyeglasses or contacts, should be in a place where they can be accessed in an emergency, such as a passport case. I once knew a fellow traveler whose eyeglasses were swallowed by the plane's commode, and he had to go without for several days until a replacement could be purchased.
7. If you travel with a notebook computer, your survival kit should contain three items: a 12- to 20- foot electrical extension cord, which can be cheaply made from lamp cord and socket and plug components purchased at a hardware or home improvement store; and a 12- to 15-foot long telephone cord extension, a three-prong to two-prong plug converter usually bright red or orange in color. (To be sure that both prongs are the same width, you may have to file one down to the other's size.) Most international hotels have 110-volt receptacles in the bathroom, but few accommodate the wide safety plug prongs and almost none take the standard 3-prong plug that will be on your computer's power cord. Also, international hotels have an uncanny ability to place the wall phone jack as far away from a power source as possible.
8. On long international flights, carry a small airplane discomfort survival kit in your carryon luggage. The kit should include, in addition to well-marked prescription drugs (to show customs officials if necessary),

over-the-counter pain killers, antidiarrhea tablets and antacids, a small tube of petroleum jelly (the size for chapped lips does well), band aids, dental floss, several safety pins, toothpicks, toilet seat covers (available commercially or in most airports), and breath freshener. I also carry a few rubber bands, sticks of chewing gum (for cabin pressure relief), and duplicate luggage keys.

9. A few things to do before you leave on a long trip: preprint letter and souvenir postcard mailing labels, trim all finger and toe nails, update immunizations and vaccines, pack necessary medical supplies such as syringes and prescriptions for them, and pack small gifts for your foreign host(s) representative of your company or your home. I like to give picture books of my home town or locally produced cookbooks.

### **Winn second box:**

#### Sample Discount Schedule

#### DISTRIBUTOR'S DISCOUNT SCHEDULE

(Discount is off manufacturer's suggested retail price in the territory)

#### Distributor's Sales Level

A B C

\$0-2,000,000 \$2,000,001-3,000,000 >\$3,000,000

#### Manufacturer's Product Category Discount

Product X 35% 40% 45%

Product Y 40% 45% 50%

Product Z

(for demonstration use only\*) 50% 53% 55%

#### 3rd Party Products

(approved by manufacturer) 25% 25% 25%

All Manufacturer's Services 15% 15% 15%

\* Limited to purchase of two demonstration kits per year comprising one each of products X & Y [to discourage sale of the higher discounted product in the demonstration kits]

#### Additional Discounts

For every English-speaking technician passing manufacturer's training course = 1% (maximum 4%)

For every English-speaking salesperson passing manufacturer's training course = 1% (maximum 5%)

For every full year the agreement is in force and distributor achieves 125% of quota (maximum 3%)

**INSTRUCTIONS:** To determine total discount, find appropriate product category and discount sales level and add to the discount any applicable additional discounts.

EXAMPLE: A distributor who has achieved previous year sales of \$2,500,000 (Level B) who sells product Y (45% discount), who has three English-speaking technicians and two English-speaking salespersons successfully trained (5% discount) and who has achieved 125% of quota for two years since the distribution agreement was executed (2% discount) would receive a total discount off the manufacturer's suggested retail price of 52% (45% + 5% + 2%). The discounts applicable can best be shown in the distribution agreement in the form of a simple graph or chart such as this.

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