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Distributor agreements

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1. Introduction

There will be many occasions in business when it is necessary to negotiate. Indeed, we do this all the time and often the exchange is continual and goes unnoticed. Negotiating is a process of bargaining to reach a mutually acceptable agreement. It is interesting to note that the origin of the word, negotiate, is from the Latin word for business, *negotium*, and indeed in modern French a negotiant is a business-person. Negotiation implies communication between two (or more) parties to find solutions to problems and a resulting outcome acceptable to all. It is not having your own way in all situations. If you decide to make use of distributors to support your internationalisation – and many routes to internationalisation involve the use of distributors – it is likely that negotiating the distributor agreement will be one of the most important tasks that you undertake. A distribution agreement is a contractual relationship between a distributor and a seller, usually the manufacturer, to sell selected products. Unlike an agent, the distributor takes title to the goods and resells them to customers in a specified geographic area. There is no contractual relationship between the seller and the ultimate customer.

2. Due diligence

Before you get to the point of negotiating a distribution agreement, you need to decide whether your chosen distributor is a company with which you can do business. This requires that you undertake appropriate checks, known as due diligence. The PROFIT factsheets on Know Your Customer (*KYC*), *Investment appraisal* and *Trade mission* will help here. Generally, it is only after you sign a distribution agreement and start working together that you really begin to understand the distributor's strengths and weaknesses. If your due diligence is inadequate, then every new weakness that you find will come as a surprise.

3. Terms to include

3.1 Standard provisions

Typically distribution contracts will cover at least the following:

- Duration of agreement
- Exclusivity
- Territory
- Minimum purchase commitments
- Logistics and shipping
- Representation and warranties
- Compliance with legislation and regulation
- Limitation of liability
- Indemnification
- Confidentiality
- Dispute resolution
- Subcontracting
- Termination rights
- Force majeure

3.2 Term

Agreements can last for a few months or many years. It is sensible, for a first agreement, to set a period that is long enough to check out the distributor but short enough that you can get out of the agreement if required, perhaps a year. You can include automatic or semi-automatic renewal that continuously adds a new year to the life of the agreement unless one party gives notice that they intend the agreement will not be renewed. Bear in mind that the distributor may expect to gain sales slowly whilst you will be looking for fast results. Be realistic about performance targets – but also do everything you can to understand the market before talking to a distributor.

3.3 Exclusive or non-exclusive?

The parties need to agree whether the agreement is to be exclusive or non-exclusive. Exclusive arrangements can be structured in two ways:

Exclusive distribution arrangement

An exclusive distribution arrangement typically:

- grants a distributor the right to be the sole seller of the supplier's products in the specified geographic territory; and
- restricts the supplier from selling these goods in the specified geographic territory directly or via other parties.

Exclusive dealing arrangement

An exclusive dealing arrangement is a restriction imposed on the distributor that requires the distributor to buy products or services only from the supplier for the duration of the agreement. In other words, they undertake not to sell competing products. If the distributor is reluctant, perhaps because you are very new or very small, focus if possible on a narrow sector so that there are no competing products.

3.4 Territory

It is important to agree the territory to be covered by the distributor. This is often defined geographically but can be defined by jurisdiction, industry, customer channel or, indeed, any other way acceptable to the parties. The agreement should specifically cover internet sales and how these are treated for the purpose of exclusivity. It is sensible to cover the remedies that might be available to either party of the other arty breaches the agreement and to cover the possibility that either party may wish to adjust the territories at some point in the future.

When agreeing a territory with a distributor, take into account the distributor’s current territory. Do not get carried away and allow a distributor to negotiate a much larger territory until they have proven themselves in their existing territory.

3.5 Purchase commitment and purchase orders

Minimum purchase commitments

The parties should agree whether there will be minimum purchase or order commitments. It may be appropriate to include clauses to cover how the minimum purchase or order commitment will be measured and the seller's remedies for the distributor's failure to meet minimum purchase or order commitments.

Accepting purchase orders

The parties should include terms that outline acceptable purchase orders. For example, the agreement should include:

- How the seller accepts a purchase order, for example through purchase order confirmation and delivery of the goods.
- Whether the seller must accept the purchase order within a stated period of time.
- Whether the seller has the discretion to reject purchase orders and, if so, on what grounds.

Cancelling purchase orders

The parties should specify the circumstances under which either party may cancel accepted purchase orders.

3.6 Logistics and shipping

Whilst the point at which title to the goods is transferred, the logistics arrangements and the insurance arrangements are covered in the sales contract for each individual purchase, there could be merit in additionally spelling out the usual arrangements in the distribution agreement.

3.7 Warranties

The parties should agree who will be responsible for meeting warranty claims, especially those arising from product defects. Remember that customers will almost always seek products with some level of guarantee so not providing a warranty is unlikely to be an option.

3.8 Legislation

There may be any number of laws that need to be observed and which could or should be mentioned in the agreement. The agreement should specify the governing law and where disputes will be resolved. If the product includes intellectual property the agreement may need to include a licence for the distributor to redistribute. This is important, for example, in computer hardware and software. The agreement also needs to cover transfer of title and risk of loss. If you have a trademark or patent protection in your home country, you may need to seek separate registration in your target country

3.9 Termination

It is important to be clear about the conditions under which the parties may terminate the agreement. There are usually two types of termination: t*ermination for convenience* and t*ermination for cause*. Agreements may use just one or both. Experienced parties generally prefer termination for convenience. Termination of agreements based on cause too often end in court. However, businesses can avoid this simply by including a *termination for convenience* clause. Ultimately, whether you want to stick with a distribution agreement will depend on performance, so take time to agree what satisfactory performance will look like.

4. Conclusion

Do not try to take advantage of your partner – indeed, you want them to think and act like your partner – so aim for balance in the distribution agreement. If possible, look at other distribution agreements before you even start to negotiate. Your Chamber of Commerce may be able to help. Distributors may require a financial incentive to take on a new product or, at the very least, may want you to undertake initial marketing costs. If you find yourself in this position, ensure that you set a maximum amount that you are willing to provide and be clear about what you expect to see in return.

5. Further information

There are many sample contracts available through a quick internet search. See, for example, www.pandadoc.com/exclusive-distribution-agreement-template/

Balzer, G (2009) Six rules for negotiating a better distribution agreement, www.neweraconsulting.com/six-rules.htm

Paranikas, P, Whiteford, G.P, Tevelson, R & Belz, D (2015) How to negotiate with powerful suppliers, Harvard Business Review, hbr.org/2015/07/how-to-negotiate-with-powerful-suppliers

Spencer, L (2021) Top tips for negotiating agreements with overseas distributors, www.sema.org/news-media/magazine/2021/01/top-tips-negotiating-agreements-overseas-distributors

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