

DISTRIBUTION AGREEMENTS

Overview

A distributorship arrangement involves the sale of products by the distributor in a third country, on his own account. The distributor contracts both with his supplier and with his customer. He becomes owner of the products concerned. He is not a representative of the principal.

In contrast, the agent represents the person appointing it in the foreign country. It will typically have authority to negotiate and conclude contracts on behalf of the person making the appointment (the principal). An agent is usually paid a commission on the basis of sales made.

An advantage of a distributor is that commercial agents are subject to mandatory rules under European Union law. These rules do not apply to distributors. These rules can be onerous and include obligations to pay compensation on termination of agency.

In the supplier-distributor relationship, the distributor and the supplier stand at arms length in a commercial relationship. Subject to certain competition law restrictions, they have considerable freedom to decide the terms and conditions of their relationship.

The supplier will have less control over the distributor's activities, than is the case with agency. The supplier cannot usually determine the pricing of products to the retailer's customers. The supplier is not liable for the distributor's actions. Because of the higher level of risk it undertakes, the distributor will normally require a higher level of margin relative to an agent.

A distributor is often given the exclusive right to sell a product within a stated territory. This is an exclusive distributorship. In selling to a distributor, the supplier passes on a greater degree of risk in relation to the product. A distributor is in business on his own account and may be more motivated, as he takes on additional business risks.

A supplier will generally not be liable for the distributor's activities, in contrast to the position with an agent.

A distributorship arrangement may be a low risk means of expanding businesses abroad. Appointing a distributor may avoid the need for a supplier to establish a base within the foreign territory. This will reduce administrative overheads and may be beneficial from a tax perspective. The supplier does not need to monitor accounts with customers, but with one distributor only.

In contrast to the position on agency, where mandatory EU rules apply, there is no compensation or indemnity payable to a distributor on termination of the distributorship agreement, unless it is specifically agreed in advance.

A supplier has less control over the activities of a distributor than over those of an agent. There is less scope for maintaining control over the method of marketing and prices. The credit risk in respect of sales is concentrated on the distributor rather than with each customer, as would be the case with an agency.

Distributorships are more regulated than agencies under from EU competition law. Where a commercial agent bears no financial or commercial risk, the EU competition rules will not generally apply.

Types of Distributorships

An exclusive distributorship gives the distributor exclusivity in relation to the supply of products or services within the defined territory. The distributor agrees not to appoint other distributors or sell products directly within that territory.

The supplier provides the distributor with local knowledge and an established business base. The distributor agrees to take on the risk and costs associated with promoting the new products. The exclusive distributor benefits from the supplier's sales and promotion efforts. The supplier can use the threat of withdrawing this facility, if target sales are not met within certain periods.

Sole distributorships are an arrangement where a single distributor is appointed within a territory, but where the supplier reserves the right to sell directly. This gives greater freedom to the supplier. The sole distribution agreement may provide that the overseas buyer undertakes to buy the seller's goods as his sole supplier.

A non-exclusive distributorship gives the supplier the freedom to sell and appoint other distributors. The terms of the appointment will be less onerous on the distributor.

Selective distributorship is where a number of distributors are appointed as part of a selective scheme. The supplier agrees with the distributor to appoint additional distributors only if they meet certain criteria. This may be appropriate where the nature of the product requires enhanced service or advice at the point of sale or where after sales support is required.

The distribution agreement will specify the general terms under which individual sale contracts are concluded. There may be an undertaking by the buyer to buy a specified quantity. A distributor is not an agent of the exporter. He does not represent it legally nor is he entitled to enter contracts or do anything on its behalf. The seller is not party to a contract with the purchaser in the third country.

The sole distributor's profit is the difference between the selling price and the purchase price paid to the exporter company. He does not earn a commission.

Export Distribution

A sole distribution agreement might be entered between an exporter and a manufacturer. In this case, the exporter is the export distributor and may be granted exclusive rights of distributing in a particular market abroad.

There are two forms of export distribution agreement. Under one, the distributor undertakes to place orders of a fixed amount annually with the manufacturer. In others, he merely undertakes to place such orders as he receives from his customers abroad. In both cases the export distributor undertakes to place the order in his own name and not on behalf of the overseas customer.

The exporter and distributor may therefore negotiate the distribution agreement in a way which is fair and equitable to both and is adopted to the particular requirements of the business and of the market.

Typical clauses

The geographical territory concerned is specified in the agreement. Sometimes an extension of the territory in the future may be allowed.

The seller is usually obliged to refer direct enquiries by consumers in the territory to the buyer. The buyer is usually obliged to pass enquiries from outside the territory to the seller.

The distribution agreement sometimes contains provisions in relation to the price which the distributor shall pay when ordering the goods. The distribution agreement may refer to a definite price or to a criteria for fixing the price. It may specify that the distributor shall pay the most favoured customer price.

The agreement will specify the goods concerned. It may refer only to certain types of goods or to a range of products. The contract may allow for extensions to new kinds of related goods.

The distributor may be obliged to offer the goods in the market. He may undertake that a minimum value will be ordered within a certain time. The seller may have a right of termination if sufficient orders are not placed within a certain period. The buyer may be required to undertake obligations in respect of advertising and publicity. The seller will not usually have this obligation. The distributor may be obliged to visit prospective customers and take other specified marketing steps.

This Guide is intended as an overview and broad outline of the matters covered in it. Its purpose is to inform and raise awareness. We are happy to offer specific legal advice on particular circumstances.

This Guide should not be relied on as a substitute for comprehensive legal advice with reference to the particular circumstances.

While we have taken due care in the preparation of this publication, we do not accept legal liability as a result of any reliance placed on anything in this Guide. The reader should rely only on specific legal or taxation advice.

© Lavelle Coleman 2009