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Distribution Agreements 101: What to watch out for before you sign on the dotted line

Distribution agreements arise in a myriad of contexts, ranging from the supply or distribution of widgets, dairy products and crude oil to software, mechanical components and silica sand. No matter whether you are a supplier or distributor, this article outlines some often overlooked, albeit important, provisions that should be included in distribution agreements.

Exclusivity

Suppliers and distributors alike will at times try to secure, to the extent possible, an exclusive distributorship. In essence, an exclusive distributorship provides a distributor with a license to be the exclusive distributor of the product in a certain territory (as discussed in more detail below).

Exclusivity can be beneficial for both parties: it allows the supplier to control the distribution, pricing, terms and conditions of the distribution of its products, and it allows the distributor to be the "go-to" distributor of the product.

An exclusivity provision will usually require that the distributor agrees not to sell any products that directly or indirectly compete with the supplier's products. Before the distributor signs such an agreement, it should make sure that:

- It will not be violating the provisions of any agreements with its other suppliers (if applicable).
- In return for such exclusivity, the supplier can guarantee a certain minimum level of products that it will deliver to the distributor.
- For example, if the distributor signs on to be the exclusive supplier of ACME products, and ACME has a slow year in which it sells very few products, will the distributor be able to make enough money only selling ACME products to survive? Conversely, the supplier needs to determine whether it will be able to fill and keep up with all of the distributor's purchase orders.

Payment

The agreement must also address how the distributor and supplier get paid under the distribution agreement. Payment may be on a per-product basis, a flat fee, or a hybrid of the two.

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As discussed above, because of potential slow years or time periods, distributors will generally prefer to be paid a flat fee, or by a hybrid structure in which it is paid a flat fee, plus additional amounts upon the occurrence of some event (like achieving certain sales targets) or a certain percentage of sales.

On the other hand, a supplier will most likely want to pay the distributor on a per-product basis, so that it is only paying for the items that it can actually sell (unless it can secure a very low flat fee structure). Generally, a flat fee or hybrid payment structure could potentially open the supplier up to unwanted liabilities in the event of a decline in sales.

Another possibility is that the distributor may, in effect, be a reseller of the supplier's products. As part of that type of relationship, the supplier agrees to supply products to the distributor, and the distributor has complete control over the marketing of the products (sale price, advertising, etc.).

The agreement must also discuss remedies in the event of nonpayment. If the distributor is the supplier's exclusive distributor, it must be clear as to whether the distributor has the right to stop distribution of all of the supplier's products until the dispute is resolved. For obvious reasons, suppliers will try and fight for provisions that allow for continued operation during dispute resolution with the distributor.

Territory

If the agreement grants an exclusive distributorship, distributors will want the broadest exclusive territory they can negotiate, and will usually argue that broad territories will incentivize them to sell as many of the supplier's products as possible.

Suppliers, on the other hand, will want the opposite — they want as many distributors as possible hitting the streets and selling their products. The size and scope of the territory will generally need to be determined on a case-by-case basis, but both parties should be aware that there are both upsides and downsides that factor into selecting the size of the territory.

Use of intellectual property

If a distributor needs, or desires, to use intellectual property belonging to the supplier as part of its business, the distribution agreement will need to address such use. That is, the agreement must include provisions granting the distributor a license to use those particular items of the supplier's intellectual property.

For example, if the distributor wants to be able to use the supplier's trade name, brand names or logos as part of the distributor's advertising of the products being distributed, the distribution agreement must include a license to use the trademarks associated with the trade name, brand names or logos used.

Likewise, if there are one or more patents covering those products and the distributor will actually manufacture the products that it sells for the supplier, rather than the supplier supplying the products sold, the distribution agreement must include a license to manufacture and sell products falling under those patents.

Since a distributor typically wants to benefit from any advertising or brand name recognition of the supplier, or inventions developed by the supplier, it is important to consider whether a license to such intellectual property must be included in the distribution agreement.

Derek Prestin and Paul Mirr are attorneys with the Ruder Ware law firm in Eau Claire. Prestin counsels clients on intellectual property law, business law, real estate law, and state and local regulations and ordinances. Mirr advises clients on a wide variety of business transactional matters, and those involved in general business litigation matters.