

Distribution, VAR, OEM and Sales Representative Channels

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Overview

- Special issues arising in distribution relationships
- Differences between distribution, OEM and VAR relationships
- Special issues arising in sales representative relationships

Special Issues in Distribution Relationships

- Transfer pricing
- Payment mechanisms
- Exclusivity
 - Minimum requirements
 - Non-competition covenants
- Term
- Termination
- Branding
- Limiting the manufacturer's liability

Transfer Pricing

- At what price will manufacturer sell to distributor?
 - Differentiate from distributor's resale price
- Can be expressed a number of ways
 - Specified amount
 - % of distributor's resale price
 - Combination of these two methods
- CAUTION: manufacturer should preserve right to change prices over time

Payment Mechanisms

- How will distributor pay manufacturer?
 - Open account (stated number of days after receiving invoice)
 - Cash-on-delivery; deposits
 - Letters of credit
- Specify currency of payment
- Limited ability to take security interest
- Interest on overdue amounts

Exclusivity

- Exclusivity: Manufacturer will not sell itself, and will not appoint others to sell
 - Variation: co-exclusive (won't appoint others, beyond distributor and Manufacturer/one other specified party)
- Critical to impose minimum purchase/sales requirements
 - Ensure that distributor is exploiting the opportunity that the manufacturer is forsaking
 - Ramp up over time; eventual decline
 - Extensions not subject simply to mutual agreement
- Non-Competition covenant: distributor will not sell any products which compete with the distributed products
 - Mutuality of obligations: I won't sell to your competitors, and you won't work for mine
 - Difficult to impose on large distributors
 - Impact on distributor if acquired

Term

- How long, in terms of years
 - Exclusive distributors typically expect a minimum of 3-5 years, and sometimes for the life of the intellectual property
- Right to extend
 - Mutual agreement
 - Automatic, unless either party gives notice otherwise
 - Subject to achieving certain success milestones

Termination

- Typical grounds
 - Breach
 - Bankruptcy
 - Change in control of Distributor
- Effects of termination
 - Return/buy-back of inventory
 - Cessation of distribution efforts
- Disclaiming damages payable to distributor for loss of distributorship
 - Particularly important outside the United States
 - May be overridden by local law (e.g., Belgium)

Branding

- Use of manufacturer's trademarks
 - Optional or required
 - Quality control standards
 - Manufacturer must be registered owner of trademarks
- Domain names
 - Make clear that domain name can only be registered by manufacturer
 - Limit Internet promotional activities
 - Prohibit certain arguably-unfair practices
 - Meta-tags
 - Buying search terms

Limiting the Manufacturer's Liability

- Disclaiming implied warranties
- Prohibiting recovery of indirect damages
 - Special, incidental and consequential damages, punitive and multiple damages, lost profits and loss of use damages
 - Common exceptions:
 - Product liability claims
 - Intellectual property infringements
 - Confidentiality obligations

Limiting the Manufacturer's Liability

- Limit direct damages to amount of agreement, amount paid in preceding months or a specified amount
 - Costs of cover, damages owed to third parties
 - May also be subject to same exceptions
- Intellectual property infringement indemnifications
 - Avoids non-infringement warranty
 - Allows manufacturer to control defense/settlement of such claims
 - Subject to exceptions (combinations, modifications, improper use)
 - Abatement clause – stop distributor from committing further infringements

Differences between Distribution, OEM and VAR relationships

- Manufacturer becomes Supplier; Distribution becomes Buyer or VAR
- Less likely to be an exclusive relationship
- Branding rights/issues are less important
- Indemnity by Buyer or VAR in favor of Supplier, in case Supplier is sued due to Buyer/VAR's products, or the combination of products

Special Issues Arising in Sales Representative Relationships

- Complying with U.S. state sales representative statutes
- Difficulties in terminating in European Union
- Defining commission obligations
- Foreign Corrupt Practice Act considerations
- Many of the same issues as for distributor (exclusivity, limiting liability, term, termination and branding)

U.S. State Sales Representative Statutes

- Enacted by 35 states
- Relatively easy to comply with
 - written agreement, with copy to sales representative (in some states, with a receipt)
 - specify rate and method by which commissions will be computed and paid
 - Pennsylvania: specify time period, territory/accounts (and whether exclusive) and whether expenses will be reimbursed
 - California: specify when commissions will be paid and any chargebacks
 - Minimum notice of termination
 - Time period after termination within which to pay commissions owed (0-45 days)
- EXCEPTION: Minnesota

Difficulties in Terminating in European Union

- Sales representatives protected by Commercial Agency Directive
- Sales representative can recover indemnity/other compensation upon termination or non-renewal in bad faith
- This indemnity/compensation cannot be waived contractually or avoided by a U.S. choice of law
- Amount will vary from country to country, but can be substantial, particularly for a sales representative which served for several years

Defining Commission Obligations

- Payable on what?
 - define Net Sales
 - upon collection by Manufacturer
 - if collections in other currencies, then how will commissions be paid?
- For how long?
 - Do commission rates drop over time, once account is established?
- For what territory?
 - what if account buys outside sales rep's territory?
 - what if outside account enters sales rep's territory?
- For manufacturer's other products and services?

Foreign Corrupt Practice Act Considerations

- U.S. statute which prohibits payments to influence foreign government/political officials to obtain/retain business
 - Even if that practice is legal/unavoidable in the foreign country
- U.S. party which makes such payments through a sales representative is still liable, if it knew
- Prohibit sales representative from making such payments, and preserve right to audit sales representative for compliance

For Further Questions:

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