



A Guide to Distribution Agreements



TOWNSENDS BUSINESS
& CORPORATE **LAWYERS**

What I need to know about...

Distribution Agreements

A distributorship is essentially an arrangement where one person distributes and sells goods by arrangement with the manufacturer or importer of those goods.

If you have a product which needs to be distributed and you either can't, or don't wish to, distribute it yourself, you will need a distribution agreement with your chosen distributor.

Likewise if you want to be a distributor for a supplier, you should make sure that each party involved knows exactly what their rights and obligations are before the product is supplied or distributed.

Distribution Agreements contain terms and conditions such as:

- What product will be distributed?
- Is there a minimum sales target to be achieved?
- What payment will be made for distributing the goods?
- What is the timing of those payments?
- What territory does the distributorship cover?
- Is the distributorship exclusive, including from the supplier themselves?
- What happens if that exclusivity is breached?
- How can the agreement be terminated?
- Who is responsible for the cost of the product?
- When is payment made for the goods sold?
- What are the rights of the parties if the level of sales are not being met?
- Can the product be changed at the supplier's request?
- Will the supplier provide promotional costs?
- Will the supplier do any of the promotion of the product?
- Does the distributor have to spend money on promotion?
- How long is the agreement for?
- Will the distributor have long enough to recover their set up costs?
- Is the product Australian-made?
- Who is responsible for after-sales service?
- What is the supplier's returns policy?
- Will the distributor require training?

- Does the supplier have product liability insurance?
- Will the supplier indemnify the distributor for losses associated with the product?
- Does the supplier or the distributor need a licence to sell the products?
- Is the product associated with a supplier's trade mark that the distributor must use?
- Is the distribution agreement within the statutory definition of a franchise?

Consider now the roles of each party for each stage and part of the transaction.

The supplier

The distributor

Issues Regarding the Supplier

It is the supplier who has the knowledge of the product. Make sure you fully understand all there is to know about the product and what your target market is so that you can direct the distributor.

It is essential that you find out exactly who is the supplier. If it is an individual talk to them about how they see the distributorship being run and find out as much about the product as you can.

The distributor may require some information regarding your financial position and likely volumes of the product.

Enquire about the supplier's business background – has the distributorship been run by someone else before you. Does the supplier have any financial substance?

If you have other distributorships operating you may make that information known to the potential distributor as an indication of your expectations.

Find out if there are other distributorships and how the supplier runs them – this will give you a good indication of the supplier's expectations and business practices.

You may be required to provide warranties as to the fitness and operation of the product if it is manufactured or imported by you.

You should obtain some warranties from the supplier regarding the fitness of the product for its purpose.

The supplier

The distributor

Issues Regarding The Distributor

You should find out as much about the distributor's experience in selling and/or distributing. It is essential that you get the right person to distribute your product as they are the person on the sales front line.

If the distributor is a company you should ask the directors to provide personal guarantees to ensure that the distributor's obligations will be performed.

It is not unusual for a distributor to appoint sub-distributors to assist them. If you don't want this to happen you should make that clear in the agreement. Make sure the distributor is responsible for payment to the sub-distributors and for their actions.

Be prepared to provide your details to the supplier of your experience in selling/distributing.

If you are a company your directors may have to provide personal guarantees that the obligations under the agreement will be performed

If you want to appoint sub-distributors to assist you make that clear from the beginning. You will be responsible for the actions of the sub-distributors and their payment. Appointing sub-distributors will not usually release you from your obligations.

The supplier

The distributor

The Product

If you are the manufacturer of the product you will have the knowledge regarding the product's characteristics, both good and bad. Prepare a package of information of the product as this will assist the distributor in selling and distributing.

It is essential that you know as much as possible about the product as you will be the front line of selling the product.

Be careful what representations you make about the product as you may be liable for misleading and deceptive conduct under the Federal Australian Competition and Consumer Act.

If the supplier provides you with product information make sure that there is reference in the agreement to that product information. In the event that the information is false or misleading you may have a claim under the Australian Competition and Consumer Act.

Make sure you know how you want the distributorship structured.

Distribution agreements can be structured in several ways.

Will the distributor buy the goods from you and pay upfront and then keep the profits on sale

OR

Will the distributor take delivery of the goods and then pay you on sale (consignment) plus your supplier's fee.

The distributor can buy the goods from the supplier for a set price and then keep any profit he makes on sale

OR

The distributor can take delivery of the goods on consignment and then pay the supplier when the goods are sold, less the distributorship fee.

The taxation considerations and GST implications must be fully investigated by you and you should seek separate financial and tax advice on this issue.

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You may not want the distributor to distribute any competitive products.

To avoid putting all your eggs in one basket you may want the right to distribute competitor's products as well.

The supplier

The distributor

The Territory

The agreement should contain:

- details of the territory
- is the territory exclusive
- if the territory is not exclusive what other distributors operate in this area

Make sure you fully understand the area and demographics of the territory. Request the supplier to provide you with any demographic studies they may have on the territory. Make sure you have these referred to in the agreement so that the supplier may be bound by them.

The Distributor may want studies and demographics on the territory. If you have these studies but cannot rely on their accuracy it is better to make no representations about the territory.

Even if the supplier does provide you with studies it is always better to double check the information by doing your own studies. If there are any differences then these should be raised with the supplier.

If you have undertaken some demographic studies you want to rely on, the distributor will want some warranty as to their accuracy and reliability so make sure you are confident of their contents.

Make sure you ascertain whether the territory is exclusive (including that the supplier can't sell direct to customers in the territory in competition with you) and what rights you have and action you can take if you find the supplier or another distributor working in your area.

If the territory is not exclusive make sure you find out exactly how many other distributors are working in the territory and what volume of sales they do so that you can ascertain the impact on your distributorship.

Even if the territory is to be initially exclusive the supplier may want the right to sub-divide the territory if it grows to a certain population size or some other significant parameter changes.

Can the supplier sub-divide the territory in certain circumstances and how would that affect your business?

The supplier

The distributor

Warranties

As the supplier you will be required to warrant, at least:

- that the information you have provided the distributor is accurate
- that the goods are as described by you
- that the territory is exclusive (if applicable)

If you require the distributor to be liable for the goods distributed and any use of those goods then you should include an indemnity clause so that the distributor indemnifies you in the event a third party customer suffers any loss or damage from the use of the goods.

It is essential that you check these warranties to make sure you are not warranting something. Make sure you have the lease document handy before putting business on the market, so that Buyers can inspect it.

You should obtain the usual basic warranties that the goods to be distributed are fit for their purpose.

If the territory is exclusive you need a warranty that it is exclusive. This includes whether the supplier is entitled to sell into the territory.

You may also require an indemnity from the supplier if third parties are going to be the recipients of the goods, so that if those third parties suffer any loss because of the goods, the supplier is liable.

It is essential that you check these warranties to make sure that your interests are protected and that any liability in respect of the services lies with the provider.

Termination of the Distributorship

If the distributor fails to meet minimum sales volume or does not pay you the correct fees and other moneys due under the agreement you should have the right to terminate the agreement.

If you breach the agreement the distributor may want to terminate. You should be given reasonable notice of intention to terminate and an opportunity to rectify any breaches.

If you fail to pay the price of the goods sold or any fees payable to the supplier or you fail to meet minimum levels of sales, the supplier will usually want to terminate the agreement.

You should be given reasonable notice of intention to terminate and an opportunity to rectify any breaches.

If the supplier breaches the agreement you should have the right to terminate the agreement.

You may not want to terminate the agreement if you have spent money on set up costs. Consider other remedies in the agreement for breaches by the supplier.

Including a dispute resolution clause in the agreement so that you and the distributor can sort out any disputes rather than terminate the agreement is a good idea.

You should always make sure you have a clause in the agreement so that you can terminate the distribution on giving written notice.

Including a dispute resolution clause in the agreement so that you and the supplier can sort out any disputes rather than terminate the agreement is a good idea.

You should always make sure that you can terminate the agreement (for no particular reason) by giving the supplier some written notice (usually 14 – 28 days). But don't let the supplier terminate unless you've had plenty of time to recover any set up costs you've had to spend in respect of the distributorship.

On termination of the agreement you must make sure you will be paid any outstanding fees or moneys by the distributor and that this right remains after termination. You may also be required to allow a run-down period to allow the distributor to sell-off or return existing stock

On termination you will usually be required to pay any outstanding fees or moneys due to the supplier. However make sure your other rights to sue for breach of contract or misrepresentation remain after termination.

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