Preventing Mistakes With Representative Agreements

by GLEN BALZER

Many factors go into the creation of a solid representative agreement. Controversial clauses in an agreement linking a supplier and a manufacturers' representative are very visible at the end of the life of a rep agreement, but are much more difficult to spot at the time of their creation. In order to avoid problems at the time of termination, the creator of a rep agreement must ensure that precarious clauses are not inserted and that certain mandatory clauses are not omitted. Here is a checklist of several common mistakes to avoid when drafting your next rep agreement.

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Termination for Cause Only

Most rep agreements involving seasoned representatives and manufacturers allow for termination for cause and termination for convenience, (or no cause at all). Less experienced partners sometimes attempt to allow for termination for a limited set of specific causes. Termination for cause is sometimes straightforward and without controversy, as when one partner declares bankruptcy. However, partners sometimes disagree over the presence of cause, and often disagree over responsibility for cause. The best rep agreements allow for termination for cause and for termination for convenience. When an agreement allows for termination for convenience, a partner wishing to

disengage from the agreement serves notice of termination to its partner with not less than 30-days notice. When the convenience clause is invoked, cause and responsibility for cause need not be argued. More important, the rep agreement does not end in a legal skirmish. Without a legal confrontation, the manufacturers' representative and manufacturer are able to focus on their respective customers and businesses without consuming management time, corporate focus and financial resources on attorneys, courts and arbitration.

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Splitting Commissions

In the early days of modern manufacturing, a customer had a single site, designed product at that site, placed purchase orders from that site, took delivery of component parts at that site, and shipped its finished goods from that site. As a result, the single point of interface between a customer and a manufacturers' representative was a single salesperson working for the manufacturers' representative. With the advent of globalization, customers spread their facilities beyond the single site and beyond the territory of a single manufacturers' representative. During the past decades, it has been increasingly common for a customer to perform engineering work in one site, issue purchase orders from a second site, and receive components and perform manufacturing at a third site.

In order to accommodate the systematic handling of commissions across multiple territories, there must be a section in the rep agreement that addresses how commissions are calculated and paid when more than one rep is involved in the sale of product to a customer. One method of dividing commissions is to allocate one-third of normal commissions to the "point of engineering," one-third to the "point of procurement" and one-third to the "point of manufacture." Commissions need not be divided equally between the three manufacturers' agents involved. However, the cardinal rule that must never be broken is that the sum of the three commissions must never equal more than the normal commission allocated to a single rep.

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Annual Termination and Semiautomatic Renewal

Parties inexperienced with rep agreements sometimes attempt to minimize the opportunity for termination. Calling for annual termination and semiautomatic renewal is a routine procedure among experienced players. In these cases, there is a provision in the agreement calling for termination of the agreement at the end of the first full calendar year after the agreement is placed in effect, and each year thereafter. Terms and conditions allow either party to submit a notice of intention to not renew 30 days prior to the end of the calendar year.

When annual termination and semiautomatic renewal are written into the agreement, both parties have the opportunity to exit the agreement, without proving cause, once per year. Using this methodology, the partnership is held together by performance and not with a collection of words in the agreement. Experienced partners always prefer to have performance as the binding force in the partnership.

The rep agreement must spell out responsibilities and obligations of both parties during and after the life of the agreement.

Termination by Only One Party — Not Both

Rep agreements that allow for termination by only one partner are biased. Experience suggests that such lopsided agreements more frequently end in a legal dispute. By allowing both parties to terminate the agreement, some legal disputes can be avoided. The best rep agreements allow either party to terminate the agreement.

Amendments Allowed Once Per Year

Relationships between manufacturers and manufacturers' representatives are organic. They are born. They develop. They grow. They mature. They decay. Ultimately, they expire. External factors periodically apply pressure to the representative and manufacturer. Those pressures sometimes call for a change in the rep agreement. If the agreement allows changes to be made throughout the year, there is little problem. However, if the agreement allows for changes only once per year, one or both partners must survive unnecessary pressure until the agreement can accommodate an annual change. The best rep agreements allow changes to be made throughout the year.

Too Much Too Fast

Every new partnership between a manufacturers' representative and a manufacturer is born in a period of bright optimism. Like marriage, there is a limit on the number of partnerships in which a supplier or representative may engage. By aligning with a new representative, a supplier is prohibited from signing an alternative representative. By aligning with a new supplier, a manufacturers' representative is prevented from signing an additional supplier. When aligning with a new representative, it is important to assign a territory that is not too large initially. If a representative is proven in only a small territory, it is not prudent to assign a large territory and hope for the best. A better policy would be to open a new representative relationship in that representative's proven territory and expand the territory gradually, after success in the smaller territory suggests that an expanded geography is wise.

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What Happens After Termination?

The rep agreement must spell out responsibilities and obligations of both parties during and after the life of the agreement. All suppliers and manufacturers' representatives understand that responsibilities of the parties must be defined during the period that the agreement is operational. However, fewer truly understand that responsibilities must be thoroughly defined for the period after termination.

Manufacturers and manufacturers' agents must be particularly careful to document the sales upon which commissions will be paid upon termination. A question that must be answered in the agreement is whether the rep is paid on shipments for 30 days (or whatever number of days is agreed), after the "notice date" or after the "effective date." Although this might be considered a relatively slight nuance, these kinds of details are the elements that lead to legal proceedings upon termination. Precise wording cannot prohibit or delay termination, but unambiguous verbiage can help avoid the expenditure of financial resources and management time spent with attorneys, courts and arbitration. A solid agreement must clearly state the responsibilities and obligations of both parties during the operating life of the agreement, upon notice of intention to terminate, and after the agreement is officially terminated.

Comparison With Standard Industry Agreements

Most mistakes written into rep

agreements are made by parties lacking experience with creation and negotiation of those agreements. Most large companies with years of experience with agreements rarely write mistakes in those agreements. Many mistakes are the result of one partner attempting to gain advantage over the other partner by inserting a bias into the agreement favoring the party with greater experience.

How does an inexperienced party to rep agreements level the playing field during negotiation? There are several methods:

- First, solicit a model agreement from your industry's manufacturers' representatives' association. Many manufacturers' representatives' associations provide a model agreement free, or at modest cost, to their membership (e.g., MANA, ERA, PTRA, etc.). The model is a good baseline from which to compare the agreement that you are being asked to sign.
- Second, use your network of friends in the industry. Although it is unlikely that your direct competitor would lend a copy of its agreement, friends at indirect competitors likely have no fear of sharing an agreement that has proven over time to be problem-free.
- Third, if you are attempting to sign a rep agreement in a foreign land, use the foreign network. An American Chamber of Commerce can be found in most countries around the world (e.g., American Chamber of Commerce in Japan, American Chamber of Commerce in Germany, etc.). If your foreign subsidiary does not yet have a connection with the local chamber of commerce, initiate one immediately. The cost of membership in these organizations is minuscule and the benefits can be enormous.
- Fourth, ask the representative or supplier with which you are negotiating for an agreement for a blind copy of two or three agreements that are currently in effect. You need not know the name of the parties in the agreement; you are just looking to establish a feel for what is considered normal.

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Leaving the Negotiation Process Strictly to Attorneys

Problems with rep agreements quite often are discovered after the agreements are negotiated and signed, even when the agreements were reviewed by corporate counsel or outside attorneys. How does this happen? Too often, attorneys eliminate onerous clauses, but are simply not aware of industry norms. They lack an understanding of the problems with agreements that arise most frequently. It is a good practice to have the agreement reviewed by both a legal professional and an industry professional. If your company lacks an industry professional experienced with rep agreements, such assistance should be sought. Having a legal professional review a rep agreement is necessary, but never sufficient.

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Competition Among Competitors

When a manufacturers' representative signs with a new product line that competes with an existing product line, the existing product line generally has the right to terminate the offending manufacturers' representative for cause; in this case, offering a directly competing product line. Most agreements have language in the agreement to handle this problem. However, what happens when a rep has two non-competing manufacturers and one of those manufacturers either expands its product line into the product offering of the other manufacturer, or perhaps acquires a product line that competes with the other manufacturer? Many rep agreements are often silent on this issue.

The commissions available to the rep upon termination because of promoting a competing prod-

uct line are usually less generous than if termination for convenience were invoked. When a rep aligns with a manufacturer that competes directly with an existing manufacturer, the rep expects to be terminated quickly, usually with minimal commissions paid on the backlog. However, in a case where manufacturers suddenly begin to compete, but with no deliberate action or intention on the part of the rep, termination and the elimination of commissions often is identical to a situation where the rep signed a directly competing manufacturer. This topic is not generally considered during negotiation of the rep agreement, but often is the basis of a legal skirmish at the expiration of an agreement. A few words addressing this can eliminate arguments at the end of a representative relationship.

Conclusion

Rep agreements are an integral tool in the construction of a relationship between a manufacturers' representative and a supplier. A well-written agreement can assist in developing that relationship. The agreement cannot extend the life of a relationship once the relationship expires. A poorly-written agreement often leads to a legal quarrel that in turn consumes management time, financial resources and the involvement of attorneys, courts and arbitration. A well-written agreement can eliminate expenditure of resources on these unproductive activities and encourage the representative and manufacturer to go about their respective businesses upon expiration of the relationship.

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