Some Thoughts On Representative Agreements

by MITCHELL A. KRAMER

I was troubled by the article "Representative Agreements Must Be Rewritten Annually" in the November 2006 issue of *Agency Sales*. The thrust of that article was that agency contracts with manufacturers should be limited to one year in order to eliminate possible litigation. The article accepts the idea that representatives are generally terminated because of poor performance and that by revisiting the relationship each year, business divorces can be easy and painless.

Our law firm has represented manufacturers' representatives for almost 30 years. Over the years we have been involved in innumerable situations where a representative feels that it was improperly terminated or shorted on commissions. We have been able to resolve almost all of those situations without the need to engage in costly and time-consuming litigation. In those cases that we litigated, the issues usually involved breach of the representative agreement. Those cases dealt with failure to pay commissions that had been earned, putting the representative out of business by hiring away its salespeople, and similar issues. The cause of the termination often turns out to be the manufacturer's merger or the sales manager's friend needing a job. In almost no case that we have handled has the representative really been terminated because of lack of performance.

If a rep agency is well-run, well-managed and effective in growing its principal's business, why should it be satisfied with a one-year contract?

If a rep agency is well-run, well-managed and effective in growing its principal's business, why should it be satisfied with a one-year contract? It is axiomatic that in almost every case the rep loses money during the first year of representation, breaks even in the second year of representation (if successful), and begins to show a profit in the third year of representation. It makes little sense for a rep to penetrate a market, bring customers to the manufacturer and then be terminated so that a direct salesperson can be hired for a lesser commission or the national sales manager's brother-in-law be able to finally find work.

Long-term contracts make sense both for the representative and the manufacturer. The representative is able to plan ahead, investing heavily in the line knowing that it will not be snatched away. Moreover, the rep's sales force has a feeling of security in knowing that the line will be theirs to grow so long as they perform. Salespeople can prospect for the future, not only for today's commissions. If the principal's products are those that require months or years in order to effectuate a major sale, it is essential that the rep contract provide that the rep will get the benefits of such sales so long as the customer continues to order and receive product.

We have had a number of cases in which a manufacturers' rep who had signed a contract that said that it only gets commissions while it is still representing the principal was terminated after bringing in an enormous contract. The manufacturer was trying to pocket the commissions earned by its successful rep. Certainly, in industries that require months or years to make a sale, representative agreements should not be rewritten annually.

It is to the manufacturer's advantage to encourage the rep to devote years to a major project in the hope that it will close. This work usually costs the manufacturer nothing. Success should be rewarded as it will encourage reps to produce.

It is to the manufacturer's advantage to encourage the rep to devote years to a major project in the hope that it will close. This work usually costs the manufacturer nothing. Success should be rewarded as it will encourage reps to produce. Perhaps the president of a manufacturing company that utilizes both reps and a direct sales force should tie part of its sales manager's bonus to the amount of commissions it pays to its reps. The more commissions, the greater the bonus. The greater the bonus, the more sales and profit for the manufacturer.

From a manufacturer's standpoint, a long-term contract which requires commitment and performance from the rep is a tremendous carrot. A rep, even unconsciously, will push harder to advance the interest of a principal that has the confidence to offer long-term stability as compared to a manufacturer that can sever the relationship on 30-days notice or at the end of each year. Offering long-term contracts will secure the services of the strongest rep agencies in a given territory without costing the principal additional commissions or bonuses. It will also create the stability that will allow the principal to minimize the number of regional sales managers necessary, and also the number of support personnel required, since well-run agencies will create fewer problems in motivation and order fulfillment.

There is ample evidence that sales decline when a manufacturer switches from sales through rep organizations to direct sales. While sales will increase over time, this is often the result of increased expenditure by the manufacturer on promotion and marketing. I suggest that even better results could be established by a real commitment by manufacturers and representatives to each other by committing to a fair long-term contract terminable only for cause. I suggest that a realistic annual quota attainable, but not easily attainable, will spur sales if quota is enforced with either a carrot or a stick. The stick, of course, is the right to terminate the contract if quota is not met. The carrot, which I have also seen work well, is a small percentage bonus on all sales for the year if quota is attained or exceeded.

The commitment between a manufacturer and its rep organization should be more than a 30-day or a one-year commitment. It should be commitment based on success in business. The rep's job is to maximize sales; the manufacturer's job is to produce state-of-the-art products at a competitive price.

A win-win long-term contract is the beginning, as well as the basis, of a successful manufacturer-rep relationship. If the contract is lived up to by both sides, it can be an important factor in the success of both businesses. ❐

ABOUT THE AUTHOR:

Mitchell A. Kramer is a partner in the law firm of Kramer & Kramer, LLP, specializing in issues affecting manufacturers' representatives and distributors. The firm has offices in suburban Philadelphia, Pennsylvania and Ann Arbor, Michigan. He is a graduate of Dartmouth College and Yale Law School. To contact the firm of Kramer & Kramer call (800) 451-7466 or (734) 930-5452.