INVITING THE BULL INTO THE CHINA SHOP

HOW THE SAVVY REP [SAFELY & EFFECTIVELY] USES LEGAL COUNSEL

EDITORIAL | JOHN E. SCHOONOVER

Reps are often reluctant to use attorneys for a number of reasons, ranging from the cost of services to fearing that the lawyer will foul up business relations with their principals. After all, the rep is a salesperson who has to make both the principal and the customer happy. And involving attorneys may often seem like inviting the bull into the china shop.

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But it doesn't have to be that way. The savvy rep retains and uses legal counsel on more than just a "last resort" basis. The savvy rep knows that legal conflicts may be avoided, principal relationships improved, business opportunities and profits enhanced, and most importantly commissions protected — through the careful and often behind-the-scenes use of legal counsel.

I like to think of the types of legal representation that the savvy rep may need to use as consisting of three phases: the "getting started phase," the "storm clouds phase," and the "lawsuit phase."

Getting Started

When the rep is getting started with the principal, a contract is formed. In virtually every case, the rep will never have more negotiating leverage than when the relationship is starting. Typically, the principal sends his form contract to the rep, and fills in the blanks or attaches schedules which set forth commission rates, products, territories, etc. As many reps have learned the hard way, these "form" contracts used by principals are often very one-sided in favor of the principal. But just how? And can the contract be changed to make it fairer to the rep?

The savvy rep sends the contract to an attorney for comments prior to signing it. The attorney should be experienced in manufacturers' agents' law. He or she must understand the types of problems that can arise, and how these contracts "should" work. If the attorney knows the rep business and is familiar with the various "forms" being typically used by principals, the attorney's review should not take that long or be that extensive or expensive.

In advising the rep, the attorney should "red flag" potentially troublesome provisions to draw to the attention of the rep. For example, the rep must be particularly wary of contracts that give the principal the right to unilaterally change key terms of the contract, such as commission rates, territorial boundaries, or taking the rep's accounts and designating them "house accounts." Careful attention must also always be paid to the termination language. Will the rep be paid for work performed and sales made, even if the sale is shipped or paid for after termination?

The attorney and rep should confer, and assign degrees of importance to provisions that should be negotiated with the principal. It is often a good idea to identify the most objectionable provisions and try to change them. Principals are often reluctant to change their forms, and may say, "All the other reps signed it." But, usually the contract language is negotiable, even if it is just to "clarify" a provision.

If the rep is able to change the most objectionable provisions in a contract, it can make a big difference later in the relationship in protecting the rep's right to commissions and even maintaining a good balance in principal relations. An agreement that is too one-sided creates an incentive to treat the rep unfairly, and often does not lead to a long relationship or happy ending.

The experienced attorney must understand that he or she may need to stay behind the scenes and let the rep deal with the principal. This is particularly true where the person negotiating for the principal is not a lawyer. If, however, the principal's attorney is dealing with the rep, then there is no reason the rep's attorney should not take over and negotiate directly with the principal's attorney.

When the rep is getting started, the experienced attorney needs to be aware of trends and emerging areas that the rep may want to address in the contract, particularly where the principal badly wants the rep and the rep has good bargaining power. One such area would be security for the rep where the rep is being asked to make a financial commitment — for example, open a new office, hire sub-reps, or drop or reduce service to other lines.

Recently, I have seen more reps negotiate for retainers, signing bonuses, or extra-long notice and termination payout provisions, all to protect their investment in the principal. These provisions will probably not be in the principal's "form" contract. This gives the rep the opportunity to turn the tables and have his or her attorney prepare the amending language, or in some cases the entire agreement.

How contracts are worded, and what is and is not included in them, are very important. The savvy rep

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knows to rely on experienced counsel to navigate the legal issues and explore his or her legal opportunities before he or she signs on the dotted line.

Storm Clouds Phase

When matters are going sour with the principal, the rep usually can sense the "storm clouds" gathering on the horizon; that is, there are warning signs. The rep may experience trouble with the principal in payment of commissions, reduction of commission rates, unexplained split commissions or "special sales," reduction of territory, a demand to name important accounts house accounts, a demand to sign a new, very one-sided contract, etc. The rep may not be ready or able to terminate the relationship, but during the "storm clouds" phase, it is critical that the rep rely on experienced legal counsel to gain an advantageous position for disputes that may come.

Positioning first requires a careful review of any existing contract with the principal. The attorney and the rep can then develop a legal strategy to maximize the rep's legal standing against the principal. This strategy should preserve the rep's rights to go after the principal later even if the rep continues to serve the principal for months or even years to come. Here, it is vitally important that the rep not sign or say anything that will waive the rep's contractual rights or create defenses that the principal will raise later, such as, "estoppel," "ratification" or "laches." These defenses essentially boil down to the principal claiming: "I was led to believe it was okay with the rep." In other words, the rep must be careful not to lead the principal to reasonably rely on a belief that the principal's actions are accepted by the rep.

Say, for example, that the principal unilaterally lowers the rep's commission rate from 10% to 7% in violation of the contract, claiming it is necessary under economic conditions. The rep does not like it, but goes along, needing the line and feeling powerless. Two years later, the principal terminates the rep. Can the rep go after the principal for the 3% in commissions that were not paid for the last two years?

The answer is: it may well depend how the rep positioned himself or herself with the principal when confronted with the unilateral reduction. In this situation, the experienced attorney might help the rep prepare a written notice to the principal stating very succinctly that the rep will continue to honor his or her obligations to serve the territory, but does not agree to the commission reduction, and reserves all rights.

Other steps could also be taken, including invoicing the principal for the difference owed in commissions, periodically objecting to the lowering of commissions, or even threatening to resign the account. The right answer will differ from case to case. The correct answer will depend, however, on the legal issues faced by the rep under the terms of the contract and the law which applies to the contract.

During the storm clouds phase, the rep must be very careful not to sign any proposed amendment to the sales agency agreement that would waive or compromise the rep's rights, including to past unpaid commissions of which the rep may not even be aware. The rep also must be careful what he or she puts in writing to the principal, and even what he or she says to the principal. Sometimes the tendency is to become emotional, and to write or say things under stress or a feeling of being victimized that later comes back to haunt the rep. For example, an email to the principal saying, "You are mistreating me, but I guess I do not have a choice but to agree to your new terms" could be disastrous. It may accurately describe how the rep feels, but it also may give away commissions.

Reps often feel that they have signed documents and done things for principals under duress. As a legal matter, however, duress will rarely be a defense to a written understanding between a rep and principal to compromise or waive a rep's contractual rights. For all of these reasons, this "storm clouds" phase is a very important time for the rep to rely on experienced legal counsel.

Lawsuit Phase

Sometimes the rep's only resort is to sue to recover commissions due. The attorney specializing in manufacturers' agents' cases will consider several possible variables in determining when, where and how to bring a lawsuit.

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collect far more in additional commission dollars
than [will be spent] in legal fees.

Does the sales agency agreement have an arbitration clause? If so, an early decision will need to be made whether to demand arbitration, or try to avoid it. Many agreements have arbitration clauses that call for arbitration through the American Arbitration Association, often referred to as AAA. As a general matter, arbitration is unfavorable to reps.

Arbitration tends to be more expensive because organizations that administer arbitrations, such as AAA, charge high initial filing fees — often involving thousands of dollars. These organizations also require the rep to contribute to the hourly costs of the arbitrator. The arbitrator will usually be a private attorney. Sometimes there will even be a panel of three attorneys. Regardless of the number of arbitrators, they will expect to be paid their standard hourly rates. These arbitrators are usually not very experienced at being a judge. They also tend to come from large law firms, and so their rates tend to be on the high end of the legal market where they practice. In contrast, filing fees for public courts are far more reasonable, and the judge is paid by the taxpayers. In a public court, the case can also be decided by a jury, which is not available in arbitration. Principals therefore often include arbitration clauses in their agreements to create barriers to justice and a big financial disincentive for the rep to even consider litigation.

If possible, reps should avoid including arbitration provisions in their contracts in the first place. But if faced with one, an experienced attorney can attempt to avoid arbitration by including in a lawsuit claims that go beyond the actual terms of the contract, or by naming additional parties to the suit who are not parties to the contract, such as companies affiliated with, but not the same as, the principal. Whether such efforts are possible or advisable depends upon the circumstances of each case.

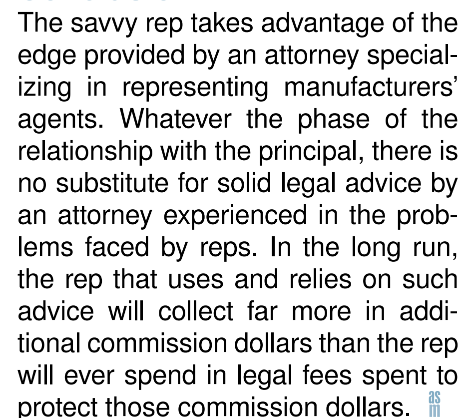
The experienced attorney also must be alert to the venue, or physical location of the court where the suit will be filed. Usually, the rep will want to file in his or her home community, if possible. The principal, if from another state, will probably want the lawsuit to be heard in its locale. Principals have been known to file "strike first" lawsuits under the guise of a declaratory judgment action (asking the court to declare whether or not money is owed), or some trumped up damage claim against the rep. They do so to attempt to control the place where the case will be heard. If the principal and rep are from different states, or countries, and the dispute involves an amount in excess of $75,000, a federal court might also hear the case. The experienced attorney will give careful consideration to all of these factors and attempt to steer the case to the location that will be the most convenient and hopefully most favorable to the rep.

Finally, the attorney experienced in manufacturers' agents' cases knows about the various commission protection acts that may apply. Many states have these special statutes in place which, through various provisions and penalties, attempt to discourage principals from failing or refusing to pay commissions due to a rep after termination of the sales agency relationship. Many of these statutes allow for punitive damages against the principal of two or three times the amount of commissions due, plus attorneys fees. No two of these statutes are the same, and they vary in terms of their effectiveness and applicability to any given contract or set of circumstances.

In my experience, many lawyers unfamiliar with manufacturers' agents' cases are simply unaware of commission protection acts and do not know to even investigate them. Similarly, many lawyers representing principals are also unaware of these statutes, and blunder into giving bad advice to their clients, such as "Don't pay, and we will settle for less later." They provide bad advice because they don't know any better and treat a commission dispute like any other contract dispute or collection matter.

The savvy rep is aware of the commission protection acts that might apply to the relationship with the principal.

Conclusion



The savvy rep takes advantage of the edge provided by an attorney specializing in representing manufacturers' agents. Whatever the phase of the relationship with the principal, there is no substitute for solid legal advice by an attorney experienced in the problems faced by reps. In the long run, the rep that uses and relies on such advice will collect far more in additional commission dollars than the rep will ever spend in legal fees spent to protect those commission dollars.

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