

INTERNATIONAL DISTRIBUTION INSTITUTE

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These notes were prepared by Ignacio Alonso (Partner at Even Abogados, Madrid, and IDI country expert for agency and distribution) for discussion purposes at the panel. They do not intend to provide a complete legal vision or advice on the subject.

Discussion panel: What type of action should be taken by a supplier when his customer is gradually becoming a distributor?

A very common situation in international trade is that where a supplier enters into a continuing relationship with a buyer of a foreign country, and this relationship gradually evolves into a distributorship. What should the supplier do when this happens? Leaving things as they are? Entering into a distributorship contract? Which are the critical issues of the various possible solutions?

• The starting point

We face a relationship between a supplier of goods and a buyer (the customer-reseller) both in different countries.

The supplier sells goods to the customer-reseller and this one resells them (without modification -and in a specific territory-) to the final clients.

This is done on a continuative basis.

No written agreement (either formally or as an exchange of letters) exists, only some regulations on prices, deliveries and orders.

• The “problem”

This purchase-resell relationship could be considered as a *distribution* relationship under some circumstances because the similarity of both agreements

Does the problem exist if there is not a continuative relationship but the scheme is produced only from time to time?

When a mere reseller can be considered “*gradually becoming*” a distributor, or the when relationship “*gradually evolves*” into a distribution agreement? When the “problem” starts?

Is that a question of the duration of the agreement?

Is that a question of the kind of relationship?

Is that a question of the party’s commercial behaviour?

• Why is that a “problem”?

The agreement can be considered as a “services” agreement (distribution) instead of a “purchase agreement” (supplier/reseller).

The jurisdiction clause (*Corman Collins* case) could depend on that.

Other legal consequences:

- goodwill indemnity;
- previous notice for termination;
- duration;
- special legal dispositions on distribution contracts (if any).

• **How this “problem” could be solved?**

If there is not any agreement (an agreement could exist if there are other “agreements” like orders, special conditions in the purchase-resell relationship, exchange of letters), therefore, no provisions at all on jurisdiction, applicable law and other clauses regulating the relationship, what the supplier (or the parties) can do?

- Nothing. Parties are very happy with their situation and they like to remain as such.

Please be aware of the possible risks particularly depending on the country of the reseller and the possible consequences in case of the termination of the agreement.

Are there any consequences of the evolution of the agreement even before its termination?

- Consider that “problem” could arise and when.

Usually this happens when there are some changes:

- The relationship is cancelled, because, for instance, the sales are not high enough, the initial circumstances have changed, the supplier’s structure has changed;
- A change the relationship with current resellers, the Supplier wants to be more present in the market, he wants to have a uniform layout, trademarks...;
- Introductions of new products, either connected or not with the already existent;
- Appointment of new resellers, either in the same or in different areas;
- Creation of a distribution network.

But this should not be neglected also in case of calm waters. Sometimes is better to face this possible problem, before it really arises.

- Verification of the situation in order to determine if the “problem” could really exist or not and to what extent.

No general rule is valid for all the relationships and all the different countries so a previous verification could be advisable.

This will depend on several factors:

- Products involved: maybe there is some differences depending on the product concerned (are there components? Products are resold as they are?);
- Market and substitutable or complementary products: Would the market (including substitutable products) affect?
- Duration: is a long-lasting agreement? Is it agreed annually but every year?
- Network: is there a parallel network of distributors to make the difference? Are there several resellers in different areas or to different products clearly individualised?
- Commercial practices: How the parties are really behaving? What are the different departments (commercial, import-export) involved in the relationship that could create obligations to the parties and how this is managed?
- Activity of the resellers: Are they really mere reseller or they also act as representatives for claims, for instance, or other obligations or instructions from the supplier?
- Has the supplier a direct relationship with final costumers?

- What should the supplier do (or avoid) if this happens?
- Would the supplier be interested in having a distribution agreement, usually more regulated and with more restrictions/obligations?
 - An exam of the internal jurisdiction applicable to the distributor, the agreement, applicable law... should be carried out in order to set the differences, if any, between both agreements, regulations and case law and to decide if such differences are relevant.
- Would the supplier be better covered leaving the situation as such? Possible risks: how to manage the relationship.
 - According to the investigation it is convenient to list possible advantages and disadvantages of both agreements or in the current situation in order to decide what steps to take
 - Possible obligations included in both agreements (indemnities, previous notice, minimum purchases...)
 - Modification of the current situation and the risk of fear.
- A possible reduction of sales, change in the elements of the relationship and, as a consequence, a reduction of the activity with the reseller;
 - With this, the reseller could not be interested in buying products, his activity will decrease and the problem could be minimised: a risk for the market.
 - How long this should be carried out? It usually will depend on the internal dispositions for calculating compensations.
 - This should also take into account the legislative dispositions, possible previous rights and a possible consideration as a sort of abuse from the supplier.
- To increase the number of resellers in the same territory;
 - As a consequence of the increase of the number of resellers the activity of the previous one will be reduced.
 - Its activity could be less interesting.
 - Attention to possible "exclusivity" clauses absolutely infrequent in this kind of relationships but take care on the real relationship (exchange of letters).
 - On the other hand this could enlarge the problem if the Supplier decides in the future to face again the situation. Future strategy should be considered.
- To introduce new products with different resellers or in different channels;
 - Different channels such as gross resellers and detail resellers.
 - This could be interesting in order to limit the importance of the reseller and will depend on its importance and the strategy of the Supplier and the complementarity of the products.
- To introduce a new distributor/agent/intermediary between the resellers and the supplier;
 - In some occasions, considering that the structure supplier/reseller is not organized, a new intermediary (organization) could be useful to create a sort of structure.
 - Resellers will then have a relationship with the intermediary instead of a direct relationship with the supplier.
- The creation of a real and parallel distribution network with different distributors/agents or by offering the already existing resellers to be part of it;
 - This needs a real decision on the new structure, to appoint new members...
 - Could be useful in case of a great number of resellers or in case of a big market which could make interesting for the supplier to enlarge his presence in the country.
 - It also depends on the relationship with the current resellers (could they be transformed in distributors: it would be easy if a network is created).

- To clarify in the orders, documents and in the correspondence the nature of the relationship or some special clauses in order to prepare possible evidences in case of conflict;
 - Take care if the reseller does not respect the new conditions, or does not accept them.
 - To avoid other clauses or conditions that could be included (even if not respected) in documents.
- To change the selling conditions;
 - Usually supplier relationships are based on annual (or periodical) conditions. The supplier usually decides these conditions from time to time for the next year.
 - A gradual change in these selling conditions could be valid to restrict the consideration of the agreement as a distribution agreement.
 - Take care about possible claims from resellers.
- To start the negotiation for an agreement based on the fact that there is not already one;
 - This could be useful to show the negotiations in case of discrepancy but could not be enough if the reseller insists in the existence of a previous one (and that this negotiations are for its modification).
 - This could be easier if the negotiation is included in the creation of a distribution network or with the appointment of other distributors.
- To sign a reselling or distribution agreement with special clauses. Difficulties for the reseller to accept?
 - A reselling agreement could also be a valid option setting clearly its conditions and making the difference with a distribution agreement.
 - The reseller will receive the certainty of a certain legal framework and could be interested in it.
 - On the other side he could see that as a restriction of his already obtained rights.
 - Usually the agreement is what it is and not what the parties call it: take care of signing a reselling agreement which hides a distribution one.
- To avoid usual practices or conditions existing in distribution agreements
 - When an agreement is carried out as a supplier-reseller relationship but some elements of a distribution agreement exist, the risk is higher.
 - With no written agreement a court can consider, taking into account the practices between the parties (even if they were not since the beginning), that the relationship is really a distribution agreement.
 - The following are some of them to avoid as far as possible:
 - Exclusivity (not present in supplier-reseller relationship)
 - Duration (usually on an annual basis)
 - Instructions given by the supplier (limitation to the way the orders are made, transport, prices and less more): the less instructions the better for a supplier-reseller relationship
 - Territory (not frequent)
 - Creation of clientele (not existent)
 - Investments (not required for supplier-reseller)
 - Minimum purchase (a reseller could obtain special prices depending on the volume but it is not convenient to oblige to a certain minimum)
 - Common image (trademark) of the resellers; licensing (not existing in a supplier-reseller)
 - To be advised by an expert.

This could be evident but our experience shows the contrary.

It is also important to choose the moment in which the expert is contacted.

Do not leave this contact to only when the Supplier wants to terminate the relationship but preferably do have a look on how the relationship is working.

Frequently is preferable to start to prepare the way with time enough (several years) depending on the final decision

- **A combination of all (most) or a part of them.**

Usually, depending on the concrete situation (a general approach is not possible) the supplier should take a combination of the previous proposals

- **What should the reseller do if this happens?**

- Usually he will be interested in considering the relationship as a distribution agreement;
- To be considered as a part of the distribution network;
- To prove the increasing of sales, increasing of customers in order to benefit of a possible goodwill (clientele) compensation;
- To ask for other elements usually included in distribution relationship: exclusivity, advertising obligations, minimum sales...