

# Commercial

## Guide to manufacturing, distribution, supply and agency agreements

This information sheet briefly explains what manufacturing, distribution, supply and agency agreements are, and some of the main issues you need to consider if you are entering into one of these agreements.

### The agreement

If you have a product and are ready to take it to market, you have a number of commercialisation options. You could make and sell the product yourself, or you could involve others in the product supply chain, such as manufacturers, suppliers, distributors and sales agents.

If you are getting someone else to make or sell your product, you should enter into a written agreement with that person recording the terms of the deal.

Even if you decide to sell the product to customers directly, you still need to put in place terms of trade to protect yourself.

### Manufacturers

Selecting a manufacturer for your products can be a difficult task, and you need to do your homework. Make sure you get references so that you can objectively assess your potential manufacturer's track record, trustworthiness and reputation. Quality control and reliability should be your key concerns when selecting the right manufacturer for your business.

Once you have selected your manufacturer, ensure you document the relationship in writing.

Here are some of the key clauses in a manufacturing agreement.

- Basic terms of trade – ordering processes, payment and delivery terms, risk and title, warranties and liability, and termination rights and consequences.
- Any specifications that must be followed, including restrictions around the selection of materials, and packaging and assembly requirements.

- Quality control requirements, such as requiring the manufacturer gives you adequate and regular samples, the right to inspect the manufacturer's facilities, and the right to return products that are defective or do not meet your specifications.
- Provisions about how product recall issues will be handled.
- Provisions ensuring the manufacturer acknowledges you own the intellectual property (IP) rights in the products, and, if permitted by law, any improvements to the products.
- Provisions ensuring that your trade marks are used only on your product.
- Provisions setting out who owns the tooling, dies, moulds or other manufacturing equipment used, and what happens to it when the contract ends.
- Confidentiality to ensure your confidential information is adequately protected.

Of course, if the person manufacturing is merely supplying its standard parts or products to you, your ability to control its activities may be limited, and demanding ownership of the product IP or tooling would be unreasonable.

### Distributors

Selecting someone to distribute your products is one of the most critical decisions you will make.

To ensure you select the best distributor for your business, do your homework and get to know your potential distributor. Are they reliable? Are they trustworthy? What is their track record?

Even the strongest distribution agreement will not prevent unethical or illegal behaviour, so ask for references from other suppliers who have distribution agreements with the distributor. Get credit checks and bank references as well.

When carrying out due diligence on your potential distributor, don't be content with generalisations – ask for specific details. For example, ask for specific



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information about their proposed marketing and distribution plans, and what resources they have to handle your products, including after-sales service. Without a good marketing and distribution plan, your product won't sell. If your potential distributor can't or won't produce a detailed plan they may be the wrong person for you to work with.

Once you have selected the right person, ensure you document the deal properly.

The distribution agreement should include the following provisions.

- A clear definition of the products. Only give the distributor rights to what they are able to sell. Consider whether future products will be included in the deal.
- Exclusivity and territory provisions that specify whether the distributor has exclusive or non-exclusive rights, and what the distributor's territory is.
- Price and payment terms – what the price is, how price changes will be dealt with, the currency of payment and payment terms.
- The obligations of the distributor to report on its activities and to provide demand forecasts.
- Where the products will be delivered to, how they will be delivered, who bears the cost, and when risk and title passes.
- The obligations of the distributor regarding marketing, inventory levels, staffing, training, technical support, after sales service, and insurance.
- The performance targets the distributor must achieve.
- Restrictions on the distributor's use of your trade marks and other IP.
- Product warranties, and limitations or exceptions to those warranties, and terms dealing with how warranty claims will be handled.

### Sales agents

You may have decided to sell your product to customers directly, but still need help finding those customers.

In some cases, it can be useful to appoint a sales agent. A sales agent usually locates customers for a product or service, in return for a commission on sales.

In many ways, a sales agent is similar to a distributor. An agent does not buy product to sell, but instead represents the seller of the product. So you should

take care when deciding who should be your sales agent.

Here is what you can expect from a typical sales agency agreement.

- Provisions outlining the powers of the agent.
- Restrictions on the way the agent may conduct itself.
- Provisions outlining how products or services are to be marketed.
- Details of how customer contracts are to be concluded, and by whom.
- Details of the after-sales service obligations of the agent, if any.
- Provisions that make it clear which sales incur a commission, and how and when the commission is paid.

### Franchising

A franchise agreement is an agreement under which in which a party grants to another party the right to carry on the business of offering, supplying or distributing goods or services under a system or marketing plan substantially determined, controlled or suggested by the first party.

If the agreement between you and a third party in Australia is a franchise agreement, then you will need to comply with the Australian Franchising Code. The Code imposes stringent rules about the disclosures that must be made to franchisees and some particular terms that must, or cannot, be included in a franchise agreement.

In New Zealand, if you choose to join the voluntary Franchise Association of New Zealand, you will need to comply with Franchising Code of Practice. This is not a mandatory code as is the case in Australia.

### Supply to customers

Many businesses supply goods to their customers under informal arrangements. Disputes and misunderstandings may arise as a result, because it is unclear what the terms of the deal are. And if something goes wrong with the goods, it may be unclear what the seller's obligations are.

So, if you are selling goods directly to customers, you should consider entering into a supply contract or terms of trade. Terms of trade will often be one or two pages long and will often appear on the seller's website, invoices or account application form.

Typical terms of trade include ordering processes, payment and delivery terms, risk and title provisions, liability provisions, and supplier warranties.

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If you are selling to consumers in New Zealand or Australia, the applicable statute (the Consumer Guarantees Act 1993 in New Zealand and the Australian Consumer Law in Australia) will limit your ability to avoid responsibility for faulty goods. Similar or more stringent consumer protection laws exist in most countries, and you need to ensure you can comply with those laws if supplying to consumers in those countries.

### **Doing business overseas**

Agreements that work in New Zealand and Australia may not work in other countries. In some countries, competition and consumer protection laws may defeat the intention of the parties. If you are doing a deal overseas you should consider getting legal advice in the key markets.

For example, European Union laws restrict the ability of parties to commercial arrangements to segment territories. They also give sales agents rights on termination of agency agreements that don't exist under New Zealand or Australian law.

We are familiar with these issues and we have relationships with law firms around the world, so we can get you the international advice you need.

### **Types of agreement**

These types of agreement can, and in our experience usually do, vary significantly in terms of size and complexity. Sometimes a comprehensive agreement will be more appropriate and sometimes a shorter one will suffice.

The approach taken will depend on the size of the deal, and on language and cultural differences. It is important to think carefully about what type of agreement is appropriate for your particular circumstances. We can advise you about this.

For advice on manufacturing, distribution, supply and agency agreements, contact AJ Park's commercial team.