

News & Types: Commercial, Competition & Trade Update

Risks and Rewards of Sales Requirements in Distributor and Sales Representative Agreements

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Suppliers, when appointing a distributor or a sales representative, will often want to include minimum sales requirements. These requirements both guide the parties' expectations and provide a method to measure the performance of the distributor or sales representative. But there are also risks in including minimum sales requirements and they should not be included unless the supplier is willing to make the effort to monitor, police and, if necessary, enforce the minimum sales requirements.

There are two frequent fact patterns that arise in a termination which also involves minimum sales requirements. In one situation, the requirement is set too low, and the sales representative or distributor consistently meets and exceeds the requirement. Rather than adjust the requirement based on growing sales, the supplier takes no action to reset the requirement. Later, when the supplier wants to terminate the distributor or sales representative, the response is, "I've always met the minimum sales requirements. You have no basis to terminate me."

The second situation is the flip side of the first. The requirement is set too high and the sales representative or distributor never meets the sales requirement. Later, when the supplier wants to terminate the distributor or sales representative, the response is, "I've never met the minimum sales requirements and you've never complained. You've waived these requirements."

The second situation is illustrated by a recent federal case in New York. (*Kobrand Corporation v. Abadia Retuerta S.A.*, U.S. District Court, Southern District, New York, No. 12 Civ. 154 (KBF), November 19, 2012)

In September, 2005 Kobrand agreed to become the exclusive distributor of three brands of wine produced by Abadia. The agreement included minimum sales requirements based on the total sales of all three brands of wine. It also provided an exemption from the requirements if Abadia was unable to produce sufficient quantities of wine to sell to Kobrand to meet the requirements. If Kobrand failed to meet the minimum requirements, Abadia had the option, but not the obligation, to terminate the agreement and, unusually, required Kobrand to pay liquidated (or fixed) damages to Abadia in such a case. Abadia could also terminate Kobrand without cause. If it did so, however, Abadia would have to give one years' notice and pay liquidated damages to Kobrand.

It was undisputed that Kobrand failed to meet the minimum sales requirements from 2007 to 2010. There was some dispute as to whether the failure in 2010 was due to Abadia's failure to supply sufficient wine to meet the sales requirements. On June 20, 2011 Abadia notified Kobrand that it would terminate the agreement effective August 31, 2011, asserting that Kobrand failed to meet the minimum sales requirements.

Kobrand then filed a lawsuit against Abadia, claiming that Abadia's termination was not within a reasonable time, so could not be for failure to meet the sales requirements and that, as a result, Abadia owed Kobrand liquidated damages. Both parties filed for summary judgment, claiming that their cases were strong enough that the court could decide in their favor without the necessity of a trial. The court could have found for either party or decided that the lawsuit required a trial to decide. In the end, the court denied both motions for summary judgment and decided that a trial was necessary.

The stakes were high. If Abadia's termination was justified, Kobrand would owe Abadia liquidated damages. On the other hand, if Abadia's termination was not justified, the only basis remaining for Abadia to terminate would be without cause, triggering Abadia's obligation to pay Kobrand liquidated damages.

The court agreed that Kobrand had failed to meet the sales requirements. While acknowledging Kobrand's claim that the supply of wine was not sufficient in 2010, the court still referred to Kobrand's "consistently low sales." But, said the court, "Abadia Retuerta waited years to act." First, in December 2010, Abadia's general manager wrote a letter to Kobrand explicitly mentioning the minimum sales requirements and Abadia's right to terminate. After that, the parties met to try and resolve their differences. These efforts were not successful, so in June 2011, Abadia sent a termination notice to Kobrand for failing to meet the sales requirements.

Of course, Abadia's position is that its termination of Kobrand was justified. But, said Kobrand, Abadia failed to invoke its termination right "within a reasonable time." In this regard, Kobrand actually used its failure to meet the sales requirements from 2008 to 2010 as a point in its favor, arguing that such a long delay was "unreasonable as a matter of law."

The court did not agree with Kobrand that the delay was unreasonable as a matter of law. But the court could also not agree with Abadia that the delay was reasonable as a matter of law. "Indeed, the Court would be inclined to find that any delay on Abadia Retuerta's part was reasonable, but, for the New York state precedent holding that "what constitutes a reasonable time for performance depends upon the facts and circumstances of the particular case." The court also decided that Kobrand's argument that Abadia's production levels were too low in 2010 also deserved a full trial.

So the court denied both parties' motions for summary judgment, therefore requiring a trial to determine the facts or, alternatively and more likely, requiring the parties to settle their differences without a trial.

In spite of the court's sympathetic language that Abadia's delay was reasonable, in the end, Abadia's delay cost it dearly. By failing to act, it gave a basis for Kobrand to file the lawsuit. The delay also cost Abadia the ability to end the litigation at an early stage and will either require Abadia to pay the expense of a trial or settle the lawsuit on less favorable terms than it could have.

As a practical matter, a supplier in the position of Abadia is not necessarily faced with only the option of ignoring the failure to meet the sales requirement or terminating the distributor. Abadia could have a) at a much

earlier stage discussed the failure to meet the sales requirements with Kobrand confirming in writing that Abadia was not waiving the requirement; b) worked with Kobrand to reset the requirement to a more attainable level; or c) terminated Kobrand. The key point is that Abadia had several options when faced with Kobrand's failure to meet the sales requirements, including the option it took – ignoring the failure, probably the worst option. As the court noted, "Abadia Retuerta waited years to act." Abadia's unfortunate situation illustrates the risks of failing to monitor, police and enforce minimum sales requirements. Suppliers who include minimum sales requirements should take note.