

## DISTRIBUTION OPTIONS

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## Summary Outline

- **Alternative Methods of Distribution**

- Owned Outlets
- Sales Agents
- Independent Distributors
- E-Commerce Intermediaries
- E-Commerce Retailers
- Franchising
- Joint Ventures
- Licensing Manufacturing Rights
- Private Label

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## Summary Outline (*continued*)

- **Advantages and Disadvantages**

- Costs
- Control over brand image and services  
(Pre-Sale and Post-Sale)
- Control over resale pricing
- Ability to terminate

- **Key Contract Provisions – See  
Appendix**

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## Owned Outlets

- Simple, do-it-yourself
- Hire own employees, directly or through subsidiary

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## Sales Agents

- Hire local agent
- Agent:
  - Arranges sales, performs merchandising
  - Does not take title
  - Receives commission on sales
- Agent or supplier:
  - Advertises and markets
  - Fulfills sales
  - Bills and collects

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## Independent Distributors

- Distributor buys from supplier
- Takes title and resells at profit

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## E-Commerce Intermediaries

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- **E-Commerce firm (e.g., Amazon)**
  - Provides website, order-taking infrastructure
- **Supplier (often called third party operator, or 3PO)**
  - Makes sale directly to customer
  - May fulfill, or have stock held by E-Commerce firm to fulfill

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## E-Commerce Retailers

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- **E-Commerce firm (e.g., Amazon) buys from supplier**
- **Takes title and resells at a profit**

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## Franchising

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- **Essentially an independent distributor with specific elements:**
  - License to use trademark in business name or products
  - Prescribed marketing plan or method of operation
  - Franchise fee
  - (Fee plus *either* of first two elements in NY)
- **Disclosure/registration requirements**
- **Restrictions on termination, other aspects**

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## Joint Ventures

- Partial ownership of foreign distribution partner
- JV can be agent, distributor, franchise

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## Licensing Manufacturing Rights

- IP owner licenses manufacturer in target market
  - Patent, copyright, trademark or trade secrets
- Manufacturer makes goods, sells them at profit
- Licensor receives royalty

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## Private Label

- Reverse licensing: Target market retailer distributes under own brand

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**+/-: Costs & brand image control  
Owned outlets**

**Advantages**

- **Maximum control**
  - Marketing
  - Presentation
  - Sales methods
  - Service
  - Control over pricing, territory, etc.
- **Retain all profits**

**Disadvantages**

- **Bear all costs**
  - Start-up capital
  - Facilities and equipment
  - Employees
  - Administration and overhead
  - Collection risk
- **Jurisdiction for liability**
- **Taxation**
- **Regulatory compliance**
  - Foreign ownership restrictions
  - Qualify to do business
  - Employment laws
- **Less local knowledge?**

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**+/-: Costs & brand image control  
Sales agents**

**Advantages**

- **Local knowledge**
  - Market conditions
  - Customs and culture
- **Agent bears local costs**
- **Avoid employment laws?**
  - Corporate agent with own EEs?
- **Options for allocating duties, costs**
  - Advertising and marketing
  - Delivery, billing, collection
    - Risk of loss could mean not a true agent
- **Control through contract**

**Disadvantages**

- **Regulatory compliance**
  - Doing business through agent
- **Taxation?**
  - Where is sale made?
- **Employment laws?**
  - Could agent be deemed EE?
- **Cost of commissions**
- **Barriers to and costs associated with termination**
- **Compensation or indemnity and other rights (in EU)**

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**+/-: Costs & brand image control  
Independent Distributors**

**Advantages**

- **Local knowledge**
  - Market conditions
  - Customs and culture
- **Local costs borne by distributor**
- **Potential to avoid jurisdiction, taxation**
- **Option to retain or assign advertising and marketing role**

**Disadvantages**

- **Give up distribution profit**
- **Some nations tax payments to foreign businesses**
- **Reduced control, except by contract**
- **Potential liabilities and costs of termination**
- **Possible protection to domestic distributors**
- **Control over resale price, territory, maybe illegal**

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**+/-: Costs & brand image control  
E-Commerce Intermediaries**

**Advantages**

- Similar to sales agency
- E-Commerce infrastructure costs borne by Intermediary
- Potential to avoid jurisdiction, taxation
- Option to retain or assign fulfillment role

**Disadvantages**

- Give up distribution profit
- Some nations tax payments to foreign businesses
- No offline marketing by intermediary
- Disincentives bricks distributors to educate, service
  - Invasion fees?

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**+/-: Costs & brand image control  
E-Commerce Retailers**

**Advantages**

- E-Commerce infrastructure costs, fulfillment costs borne by Intermediary
- E-Commerce Retailer may operate on low margin
  - Lower final price
  - Higher supplier profit?

**Disadvantages**

- Give up distribution profit
- Reduced presentation control
- No offline marketing by intermediary
- Disincentives bricks distributors to educate, service
  - Invasion fees?

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**+/-: Costs & brand image control  
Franchising**

**Advantages**

- Similar to independent distributor advantages
- Franchise fee may provide working capital/income
- Control though marketing plan, contract

**Disadvantages**

- Give up some distribution profit (but franchise fees)
- Some nations tax payments to foreign businesses
- Regulatory compliance vs. lack of regulation
- Administrative costs to monitor franchisees
- Risk of poor performance

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## +/-: Costs & brand image control Joint Ventures

### Advantages

- Same pluses as form used
- Added control through ownership, management rights

### Disadvantages

- Same minuses as form used
- Potential jurisdictional and tax exposure
- Some nations restrict foreign ownership
- Beware of minority protection

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## +/-: Costs & brand image control Licensing manufacturing rights

### Advantages

- Very low cost
- Royalty income

### Disadvantages

- Cost to monitor license compliance, especially QC
  - Risk to brand equity, TM
- Risk of lax IP enforcement in target country
- License registration?
- Foreign payment restrictions?
- Loss of distribution profit
- Reduced control, except by contract
- Tax Implications

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## +/-: Costs & brand image control Private Label

### Advantages

- Minimal costs
- Partner's distribution strength and scope

### Disadvantages

- No brand equity
- No control over marketing, sales or service
  - Can have performance standards
- Potential consumer protection liability

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### +/-: Control of resale prices

- **Reasons for control**
  - Brand image
  - Enhance profit margin for services
  - Cap profit margin for competitiveness
- **Regulation of RPM**
  - Varies by jurisdiction, even within US
  - Europe prohibits (pressure to comply with suggested resale price)
  - Latin America: Relative monopolistic practice
  - Canada permits (was criminal, now civil), provided supplier conduct does not lead to adverse effect on competition
  - *Leegin*: US Supreme Court applies rule of reason
    - But anticompetitive in some circumstances
  - States may differ: NY, CA, NJ, MD, others
  - Generally OK if unilateral – supplier makes “resale”

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### +/-: Control of resale prices

<p><b>RPM Permitted</b></p> <ul style="list-style-type: none"> <li>• Owned Outlets</li> <li>• True Agents</li> <li>• E-Commerce Intermediary</li> <li>• Controlled joint venture</li> </ul> <p>Alternative methods</p> <p><b>Colgate policy: Unilateral condition for dealing</b></p> <p><b>Minimum Advertised Price policy</b></p> <ul style="list-style-type: none"> <li>• Condition for dealing</li> <li>• Condition for co-op payments</li> <li>• EU more restrictive</li> <li>• Canada generally acceptable</li> </ul>	<p><b>RPM Restricted</b></p> <ul style="list-style-type: none"> <li>• Independent distributors</li> <li>• E-Commerce Retailer</li> <li>• Franchisees</li> <li>• Licensees</li> <li>• Minority joint venture</li> </ul>
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### +/-: Termination Rights

<p><b>Unrestricted</b></p> <p><b>Subject to contract terms:</b></p> <ul style="list-style-type: none"> <li>• Owned outlets</li> <li>• True agency in US           <ul style="list-style-type: none"> <li>- Some payment requirements</li> </ul> </li> <li>• Most independent distributors           <ul style="list-style-type: none"> <li>- But Belgium!</li> </ul> </li> <li>• E-Commerce Intermediaries and Retailers</li> <li>• Some franchises</li> <li>• Most licenses</li> </ul>	<p><b>Restricted</b></p> <ul style="list-style-type: none"> <li>• Agents in EU (Mandatory compensation – Dir 86/653/EEC)</li> <li>• In L.A. by operation of law or old contracts prior to legal amendments</li> <li>• Some U.S. franchises           <ul style="list-style-type: none"> <li>- Notably CA, NJ, WI, PR, VI</li> </ul> </li> <li>• Some industries, some states           <ul style="list-style-type: none"> <li>- Beer, wine, spirits</li> <li>- Auto dealers, gas stations</li> <li>- Farm equipment</li> <li>- Others</li> </ul> </li> </ul>
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## +/-: Termination Rights

- **Typical restrictions:**

- **Good cause – narrowly defined**
- **Right to cure**
- **Right to renew**
- **Injunctive relief**
  - **May need to show irreparable harm**
- **Fair market value of distribution rights**
- **Unilateral modifications or certain discretionary prerogatives**

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## Lessons

- **Differences are very fact-based and vary by jurisdiction**
- **The time to plan is *before* selecting a method of distribution**

**Get knowledgeable local counsel early!!**

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## Thank you!

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### Key Contract Provisions: Product Definition

- Specified products only
- All products under specified TMs
- All products meeting specifications
- Right of first refusal for new products
  - Same TM
  - Other TM
- Single agreement for all products
- “Most favored” provision

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### Key Contract Provisions: Exclusivity

- May supplier sell to others in territory
- May supplier sell directly in territory?
- Protection against gray market imports?
- Profit passover or invasion fees
- Reserved customers or categories
  - National or regional accounts
  - Invasion fees
- Internet sales

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### Key Contract Provisions: Exceptions to Exclusivity

- National Accounts
- E-Commerce
- Duty-Free, Transportation, Military, Diplomatic
- What is effect on pre- and post-sale service?
  - Can invasion fee address?
  - Other incentives?

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## Key Contract Provisions: Exclusivity

- **Distributors generally want exclusivity**
  - Avoids free-riding
  - Allows coordinated marketing of portfolio
  - Focus is on interbrand competition with competing brands, not intrabrand
- **Should suppliers want exclusivity?**
  - Do you want distributors competing with each other or with your competitors? On price or other metrics?
  - Does product require investment in:
    - Marketing and promotional events
    - Education and other pre-sales service
    - Warranty or other service

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## Key Contract Provisions: Restrictions on Competition

- **Competing products restrictions**
  - Need to define specifically
    - Beverages
    - Alcoholic beverages
    - Beer
    - Imported beer
    - German beer
    - Dark beers from Germany
    - Munich Oktoberfest style beers
    - Bottled Munich Oktoberfest style beers
  - During term v. post-term

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## Key Contract Provisions: Restrictions on Competition

- Ancillary to agreement's purpose
- Reasonable as to:
  - Duration
  - Geographic scope
  - Activities restricted

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## Key Contract Provisions: Indemnification and Insurance

- Breaches
- Product liability, recalls
  - Distributor modification, storage, handling
- IP infringement
- Claims of prior distributor
- Proven claims v. alleged claims
- Liability insurance
  - Amounts
  - Additional named insured

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## Key Contract Provisions: Termination

- Without cause where lawful
- Performance standards
  - Sales v. purchases
  - Sales v. execution
  - Consistency of enforcement
- Other breaches
- Changes in ownership or control
- Financial condition

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## Key Contract Provisions: Termination

- **Notice**
  - Cure periods
- **Inventory repurchase**
  - Mandatory
  - One party's option
  - Mutual option
  - As agreed
- **Non compete/Non solicitation**

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## Key Contract Provisions: Termination

- **Compensation**
  - **Formula**
    - Sales multiple
    - Profit multiple
    - Others
  - **Fair market value**
  - **Fair compensation encourages distributor investment**
  - **New distributor more likely to pay for rights**

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## Key Contract Provisions: FCPA Compliance

- **Foreign Corrupt Practices Act prohibits bribery of foreign officials, political parties, candidates**
- **Strict liability for acts of controlled joint venture**
- **Liability for 3<sup>rd</sup> party acts – e.g., agents, distributors – if knowledge**
  - Constructive knowledge, willful blindness, deliberate ignorance
- **UK Bribery Act - wide jurisdiction if any business in the UK; strict liability; extends to private actors**

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## Key Contract Provisions: FCPA Compliance

- **Take steps before, in and after contract**
  - **Due diligence to vet potential partners**
  - **Contract provisions**
    - Representation that have not violated
    - Agreement to comply – spell it out
    - Reporting obligations, audit rights
    - Subdistributors require due diligence, approval
    - Provisions are material, ground for termination
  - **Ongoing training, monitoring, audits**

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