

Doing Business in Israel - Distribution Agreements

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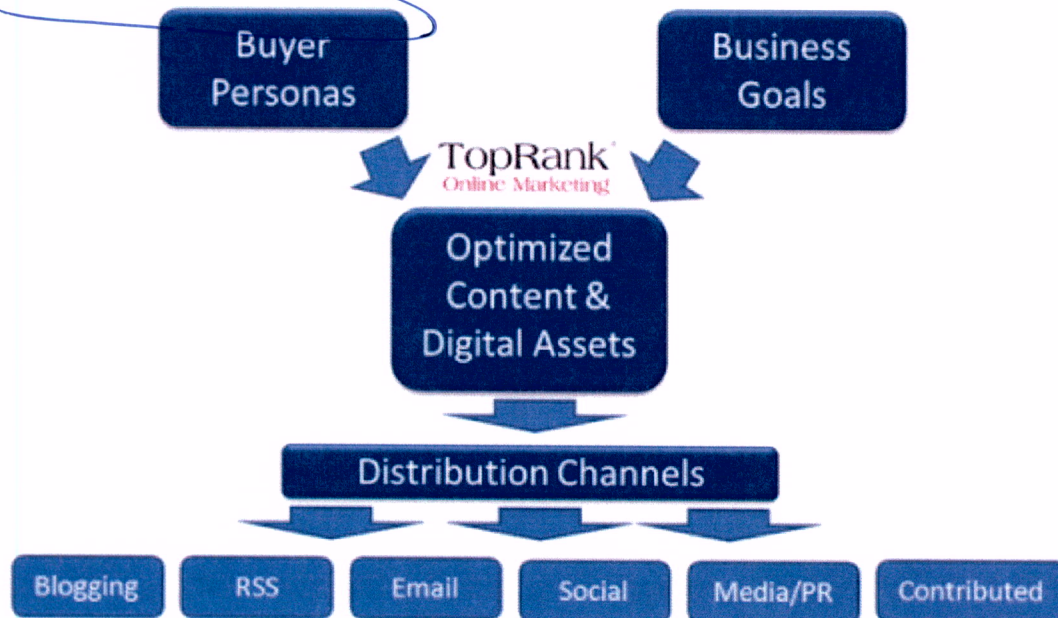


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Do's and Don'ts

How to sign a distribution agreement without, eventually, being dragged to court.

Congratulations. Your company has inaugurated a new product and the time has come to market the product overseas. You have been approached by businessmen abroad to serve as distributors of a product that can be integrated in the sales of your company. We will now specify in a nutshell a number of rules that will assist you in avoiding a long, tiresome and painful legal dispute with your contracting party, should you wish to discontinue the contractual relationship. In any case, it is recommended not to sign a so-called "standard agreement", seeing that its conditions may have a crucial significance in the long run.

Exclusivity: It is quite likely that the question of exclusivity will arise right at the beginning of the negotiations. Whereas the owner of the rights of a product (for convenience's sake he will be defined as the "supplier") is interested in appointing a number of distributors in order to increase the sales' potential, it is the distributor's interest to be the sole player in the market, without any competition. Therefore it is important to state clearly in the agreement whether the distributor has received exclusive rights of distribution or not, and whether additional distributors may be appointed during the period of the agreement.

In what concerns the distributor's interest, it is recommended to obtain the exclusivity in the territory the agreement deals with. If exclusivity is not granted, the distributor may find himself competing with other distributors (including the supplier himself), and being drawn into large expenses when trying to introduce the product into the market, while at the same time the other distributors will profit from the fruits of the investment of the distributor who was the first to operate within the agreed territory.

Notice of Termination: The more the supplier may wish, within the framework of the negotiations, to shorten the period of prior notice that has to be granted to the distributor before the agreement comes to an end, the more likely it is that the distributor will want to lengthen this period in order to enable him to get rid of the existing stock and to release relevant employees, as well as to prepare for the termination of the agreement. In this connection, we recommend the establishment of a formula for determining the period of the prior notification depending on the length of the contractual relationship, so that the longer the contractual relationship lasts, the more "generous" the length of the notification period will be. On the other hand, if the period of contractual relationship comes to an end after a year or less, it will lead to a relatively short period of notice.

Repurchasing Stock from the Distributor after the Agreement Expires: In many agreements no solution is given to the stock the distributor still holds after the expiry of the agreement. Often, the supplier believes it is best not to raise this issue for it may compel him to buy back products that have been sold to the distributor. However this assumption may turn out to be an unpleasant mistake. In this context, if the distributor is "stuck" with a stock that the supplier is unwilling to repurchase, the products may be sold at an especially low price only in order to get rid of the old stuff. This will be detrimental to the supplier, for the market will be flooded with products sold at prices that no distributor (especially a new distributor) will be in a position to compete with. Moreover, the courts will not always be willing to come to terms with a situation where the distributor will be left with goods purchased by the distributor at high value (**sometimes purchased under a minimum quantity clause**) while not being able to sell the said goods, once the agreement has come to an end. It is therefore recommended to set up a clear mechanism concerning the acquisition of the existing stock by the supplier, at the end of the agreement, including the way the sum of the acquisition will be determined. This will enable the distributor to pass on the stock to a new distributor if appointed, or to send it back to the supplier. This formula should make sure that the distributor receives an agreed-upon payback for the products he is unable to sell. Moreover, a distinction should be made between products or spare parts that are relatively new and can be easily sold, and old products that have completely lost their market value.

Service, Warranty and Product Liability: As a rule, the distributor is required to service, warranty and support the product, as well as to train professional staff who will have the knowledge and expertise of marketing the product and supporting the same thereafter. The agreement should include procedures for refunding defective products, as well as dealing with customers' complaints. The supplier will thus be able to improve the product and instruct the distributor on matters of servicing. Yet it often happens that the distributor has to cope with failures of the products and with complaints of local salesmen and customers concerning the malfunctioning of the product. Beyond the fact that a defective product may damage the distributor's and the supplier's reputation, the distributor may find himself being sued in court for damages that were caused by a defect or by deficient functioning of a product, also in his capacity as the importer of the said goods. It is therefore important to make the appropriate indemnification undertakings in the agreement, all this to ensure that the supplier will cover the expenses and losses in connection with any such 'Product Liability' lawsuit. It is also recommended to agree in advance as to the insurance coverage, so that the insurance policies will cover all the relevant risks, including lawsuits that the end-consumers may file after having purchased the product from the distributor.

Jurisdiction and the Governing Law: It is only natural that each party should want to determine, while the agreement is still being negotiated, the governing law that will be applicable to the agreement and the place where the lawsuit will be held, according to where its interests are best treated. As a rule, a supplier located, for instance, in England, is most likely to ask that the case be judged according to English law and that an English court be authorized to hear the case. On the

other hand, a supplier who resides in Tel Aviv will want an Israeli court to hear the case, according to Israeli law. In practice, the party that has the stronger bargaining position or is less enthusiastic about carrying out the agreement usually has the upper hand (or will force its will upon the other party's lawyer).

It should be emphasized that Israeli courts do not automatically recognize every jurisdiction clause which is stipulated in the agreement, and that there are other considerations that a court will take into account before allowing the case to be judged in another country. Thus, the court will consider the wording of any given jurisdiction clause, which is the proper forum to adjudicate the claim (including the question of where most of the witnesses reside) and whether there are further considerations to take into account, all this despite any other agreed upon jurisdiction stipulated in the agreement. However, appointing a third neutral country to adjudicate any future claims, (including the law prevailing in that country), may serve as an incentive to the parties to settle the conflict between them, out of court.

International Arbitration: A lot has been said concerning the question of whether it is preferable to adjudicate a claim in a court of law or through arbitration. If we try to sum up the arguments of those who are for arbitration, we will find that they claim that in most cases a reputable arbitrary institution will appoint professional arbitrators, well specialized in the field where the conflict lies and that the arbitration will take place under conditions of confidentiality, in camera, so that no inside information about the parties leaks out into the media. It will also be argued that the arbitration is generally entertained, excluding the use of the strict procedures applicable in courts, while also disregarding the rules of evidence that are so often a hindrance to uncovering the truth, while, at the same time, giving the party equipped with lawyers who possess better expertise in civil procedure, a significant advantage. Moreover, it is often argued that the hearing of various applications relating merely to procedures often comes at the expense of solving the real conflict in question. The arbitration is considered to be a relatively fast procedure which is supposed to solve the dispute efficiently, with no possibility of dragging it into further legal instances - a process that will take several years.

On the other hand, those who support adjudicating a claim in a court of law will claim that within the courts there are professional judges in the various fields whose expertise the clients can use. They will also claim that the rules of procedure and the evidence help the client make use of all the tools at his disposal to prove his claims. Also, many cases which have been entertained by arbitration took many years. The issue of the costs of the procedure is also sometimes raised. For, regardless of the fees paid to the lawyers, a professional arbitrator's fee or that of an arbitration institute is quite often way beyond the legal costs of the court.

In our opinion, it is not possible to determine what framework is best, for it will be possible to come to a conclusion about a given agreement only after having analysed the interests and the sensitivities arising from the conditions of the agreement, in relation to the distributor and the supplier.

It is not possible, within the framework of this article, to cover all the issues that give rise to conflicts after a distribution agreement has been signed, but the subjects we did mention are typical of most such disputes. Drafting the agreement with prudence, while keeping in mind future interests while addressing potential points of conflict may ensure not only a solid and stable bargaining position during a legal conflict, but also a means of preventing disagreements in the future.

Jonathan Kahn, Advocate (Barrister at Law), Jonathan Kahn & Co., Law Offices & Notary. The firm specializes in commercial law, international Trade, Customs, Indirect Taxation and Civil

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Jonathan Kahn was born in Tel Aviv in 1961 (his mother was London born and his father was a refugee from Germany who escaped with his family to Palestine in the late 30s of the previous century). He holds an LLB degree from Kingston University in England (1988). He has been a member of the Israeli Bar since 1991 and of the English Bar (Barrister at Law) as of 1989, and was authorized as a notary in Israel in 2007. He served as a member of the committees of: The Israeli Bar: Property, Land-law, Civil-Procedure, Evidence, Contracts, Customs and V.A.T.; International Relationships; Independent Lawyers; and the Insolvency and Rehabilitation of Companies. He has published several articles in the area of Corporate Law, Contract Law, International Agreements and Indirect Taxation. Prior to the establishment of an independent practice, Jonathan specialized in commercial law and litigation in a leading Israeli law firm (Naschitz, Brandes & Co.). He is owner of a private office and partner with other lawyers from 1993 up to Daphna Kahn, joining the firm in 2005. Jonathan deals mainly in representing companies in cases having a complex technological nature, including the representation of companies in the high-technology and the communication arenas, claims in the fields of hardware and software, disputes between shareholders and partners, and representation in cases of control contests, as well as conflicts between entrepreneurs and investors in corporate enterprises. email: kahn@khklaw.co.il



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More from Johnathan Kahn about setting up a distribution business in Israel. This article includes information on international arbitration, repurchasing agreements and exclusivity.
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