



BUY-SELL AGREEMENTS: THE RELATIVE NATURE OF BUY-SELL AGREEMENTS FOR MANUFACTURER'S REP SALES AGENCY

Published as a service by:

Manufacturers' Agents Association for the Foodservice Industry (MAFSI)
1199 Euclid Avenue, Atlanta, GA 30307

Tel: 404-214-9474 • Fax: 404-522-0132 • Email: Info@mafsl.org • Web: www.mafsl.org



The Question

Occasionally in my law practice I am consulted by manufacturers' representatives and their corporate lawyers to help them to establish the value of an interest in a manufacturers' representative sales agency for purposes of a shareholder buy-sell agreement or for the outright sale of the agency. A typical reason why this would occur could be for succession planning purposes whereby an owner of the sales agency is attempting to establish a dollar value for the respective owners' interests. In the event of the death of an owner, most manufacturers' representatives are disinclined to be in business with their ex-partner's surviving spouse. In other instances, one of the owners may be considering retiring with a junior owner taking over the agency; a father may be selling to a son; or in other instances, one of the owners is just fed up with the sales business and wants to retire and play golf.

Many attorneys who are very experienced in corporate law, have little experience with the intricacies of the manufacturers' representative business. The value of a manufacturers' representative sales agency is often dependent upon some key factors which may not appear obvious to the typical legal practitioner. Ascertaining an accurate value of a manufacturers' representative sales agency can be an elusive endeavor.

During these consultations the corporate lawyers often ask, "What dollar value should we use for the stock?" They are often perplexed with my answer.

Answer To The Question:

The answer to the question, "What dollar value should we use for the stock?" is generally that there is no answer. After I tell the lawyer this, I then usually advise him to "Search not for the correct answer, Grasshopper: Search for the correct question."

The corporate lawyers generally look at me with a vacant stare, especially the ones who are younger than 50. Once they are able to verbalize their response it is often,

Why are you playing mind games? All you have given us is a conundrum. All we want to know is how much Mr. X's interest in the sales agency is worth. Why can't you just tell us what number to put in the buy-sell agreement so that we can plug it into our word processor and print out a nice contract that everyone can sign and be happy with? Why are you being so difficult?

I answer:

It is not a question of being difficult. You have come to me for an answer to a question that has no answer. You must first ask the right question.

What is the right question, teacher? And then I say, " Ah, now you have finally asked the right question."

The Right Question:

Once the corporate lawyer has been able to let go of his preconceived notion that the value of his client's interest in the manufacturers' representative sales agency is a quantifiable number which can be calculated with mathematical certainty, we are able to make some progress. Some times this is a painful process which involves the gnashing of teeth and blustery pontificating. Sometimes I am looked at with another vacant stare, a polite thank-you and then a good bye. With more enlightened and open-minded corporate lawyers who have no fear, we are able to proceed to the next step. It is at this time that I help them to understand the process of solving this problem for their client. It is sometimes difficult for lawyers to be able to let go of their perceived need to know everything and to be the providers of ultimate wisdom for their clients.

For those who are able to stay with the process, I give them a series of steps which must be completed before we can proceed. This is sometimes referred to as the "Wax on - Wax off" process. I ask the lawyer and the manufacturers' representative to do the following for our next meeting:

1. Produce a copy of all written agreements with each principal of the sales agency. If there is not a written agreement for each principal, then state the general terms and conditions of the non-written agreement. For each of these agreements calculate the termination value of the contract.

I am ordinarily then asked, "What does 'termination value' mean?" I respond that it is the anticipated commissions which would be paid after termination in the event that the principal sent a termination notice today. This is a relatively easy calculation in the event that the sales representation agreement contains a provision for post-termination commissions. If it does not or if there is an oral agreement, I will generally need to get more involved in this aspect of the process.

2. Prepare a spreadsheet of all current commissionable business. In this spreadsheet, identify each part¹ which is in production and include the following information:
 - a. Identify the person at the sales agency who procured the principal for the agency;
 - b. Identify the person at the sales agency who procured the purchase order for each commissionable part;
 - c. Identify the person at the sales agency who performed the day-to-day work with the customer. Often the client then asks, "You mean the one who does the servicing?" I then have to tell them without equivocation,

 Servicing is a term which should be banished from your lexicon. You do not service. You only sell. If you are paid on commission then you only get paid if there is a sale. There is no servicing. There is only selling.

Sometimes this causes great perplexity. But once there is understanding of this concept, we are able to proceed.

- d. Estimate the anticipated life of the part/program.
3. Prepare a spreadsheet of all anticipated future commissionable business covering approximately the next three to five years. Include the same information as suggested in paragraph 2.

Once we have the spreadsheets completed, we can begin to finalize the process to solve the client's problem.

Additional Key Factors:

In working through this process, there are some additional key factors which will need to be evaluated. These include:

- The strength of the relationship with each principal of the agency. For example, if the selling owner leaves the agency, will this cause a principal to use the occasion as an excuse to terminate the relationship?
- The effect that the market will have on the sales commissions that will be earned over the course of the next three to five years.
- The probability of the occurrence of any significant events which could materially affect the sales commission flow. For example, are there any mergers, acquisitions or joint ventures on the horizon which could either significantly increase or significantly decrease the volume of production business and therefore commissions? Are there new product lines or programs in the design and engineering stage which will be in production shortly? Are significant programs or parts in the process of being phased out?

Often times it is difficult to quantify the significance of these factors. They are however, important considerations in the overall process. It is very important for the parties to have a clear understanding of the universe of potential future commission flow when reaching an agreement on the sale of an interest in the manufacturers' representative sales agency.

By now it should become evident that there are many problems with attempting to quantify an exact number for the purchase price of a seller's interest in a manufacturers' representative sales agency. If a quantifiable number is used, then it can be unfair to the seller if shortly after closing, the following occur:

- Sales dramatically increase due to market conditions.
- New product lines or programs are implemented by the customer which significantly increase commissionable sales.
- New customers are secured through acquisition, mergers or joint ventures.
- New principals are acquired as a result of the prior reputation of the agency.

It can be unfair to the purchaser if shortly after closing, the following occur:

- Sales dramatically decrease due to market conditions.
- Product lines or programs are lost which significantly decrease commissionable sales.
- Customers are lost due to mergers, acquisitions or joint ventures.
- One or more principals use the occasion to terminate the sales representation agreement with the agency.

In my opinion, the best way to fairly compensate the selling owner for his interest in the sales agency is to create a formula for an equitable sharing of commissions for a specific period of time. This also is generally the fairest way for the purchaser. By using a commission sharing formula, both parties share in the risks and benefits of significant changes in commission flow.

Another reason why a commission sharing formula is often the best way to compensate the departing owner is the fact that most sales agencies have few or no "hard assets". There is usually no significant machinery or equipment, no inventory, often no real estate, etc. If the agency has any of these assets, then they can be evaluated using traditional appraisal methodology. Generally the only true asset of a sales representative agency is its commission flow. Commission flow, as we all know, can sometimes come and go with the wind.

Why a commission sharing formula is often the best way to compensate the departing owner is the fact that most sales agencies have few or no "hard assets"

If the commission flow is higher than anticipated, the seller should get more money for his interest in the agency. If the commission flow is less than anticipated, the seller should get less. In most buy-sell transactions, it is the commission flow which funds the purchase of the agency.

If a manufacturers' representative signs an agreement to purchase an interest in a sales agency for a specific sum of money which is predicated upon a specific commission flow and that commission flow is significantly reduced, then the buyer ordinarily still has the responsibility to pay the specific sum regardless of whether or not there are sufficient commissions to justify the purchase price after the sale. This is a situation which no purchasing manufacturers' representative should ever be in.

If a manufacturers' representative signs an agreement to purchase an interest in a sales agency for a specific sum of money which is predicated upon a specific commission flow and that commission flow is significantly increased, then the seller is ordinarily limited to receiving only the specific sum regardless of whether or not the commissions have significantly increased after the sale. This is a situation which no selling manufacturers' representative should ever be in.

A Suggested Formula:

Below is my suggested formula for compensating a departing owner. In the automotive industry there can be hundreds of individual parts in production at any given time. I recommend that the formula be utilized for each individual part. In some cases as an alternative, the formula could be used for each individual customer or maybe even for each principal. My suggested formula which should be used for each dollar of commission received is as follows:

1. X% (e.g., 25%) to the person who procured the principal;
2. X% (e.g., 25%) to the person who procured the customer/account;
3. X% (e.g., 25%) to the person who procured the purchase order;
4. X% (e.g., 25%) to the person who will be handling the day-to-day customer contact.

This formula should be applied to all of the business which is in production as of the effective date of the sale or closing for the life of the parts or for a specific agreed upon time period. In addition, the formula should be applied to all new business which was either quoted or for which significant work was performed, prior to the effective date of the sale or closing. The total paid to the selling owner by the purchaser for the life of the parts or for the agreed upon time period is the "purchase price".

Can There Now Be A Quantifiable Number?

Once both parties to the transaction have gotten this far, only then will I recommend that they have a discussion about a quantifiable number to be used in their buy-sell agreement. I usually tell them that if they decide to use an exact number, that number is not a number which should be calculated by their attorney or CPA. It should be a negotiated number agreed upon by the buyer and seller using their knowledge of the business and the principles discussed in this article. If the two salespeople can sit down, use the principles in this article, and then decide upon an exact number which they are both agreeable to, then more power to them. Some people have difficulty with the concept of a floating purchase price for their stock interest. As long as both parties take into consideration all of the factors which I have discussed, then a quantifiable number can be a realistic option. It is usually best for the actual sales people who are involved in the business to come up with this number and not the "experts". If a quantifiable number is used, both the buyer and seller should still consider including a provision in the agreement to address extraordinary events affecting commission flow after closing.

A Suggested Formula:

Many manufacturers' representatives at some time during their career will be in the situation where it becomes necessary for them to hire someone to ascertain the value of their interest in a sales agency. If and when this happens, you should try to involve an attorney who is knowledgeable about the manufacturers' representative business. Due to the intangible nature of the key asset of a sales agency, i.e., commission flow, the typical paradigm for corporate buy-sell agreements has little application. If your attorney is operating under the presumption that it will be necessary to quantify the value of the interest in the sales agency to be transferred, you should have a serious discussion with him early on in the process. If your attorney refuses to open his mind to the possibility that negotiating a quantifiable purchase price may not be the best option, I would recommend that you hand him a copy of this article and ask him to call me if he has any questions.

This article was written by Randy Gillary. He can be reached using the following information:

Randy Gillary
Law Offices of Randall J. Gillary, P.C.
201 W. Big Beaver Rd., Ste. 1020
Troy, MI 48084
TEL: 248-528-0440
FAX: 248-528-3412
rgillary@gillarylaw.com
www.gillarylaw.com