Non-Compete Language in Sales Rep Agreements

BY RANDALL GILLARY

I was working on a sales representation agreement for a client of mine recently involving his representation of an automotive supplier. An issue arose which I thought may be helpful for MANA sales representatives. I will first address some of my general thoughts regarding non-compete agreements for sales reps. I will then address the problem that arose that may be enlightening for MANA members.

General Thoughts

The principal for the sales representation agreement I was working on insisted on a non-compete provision with language that prohibited the sales representative from representing any other principal with competing products during the term of the agreement and for one year thereafter. The principal's request for the non-compete provision during the term of the agreement was reasonable. I have mixed views, however, regarding the one-year non-compete after termination. This is for the reason that in the automotive industry purchase orders are often solicited years in advance. The one year that the sales representative is not representing another supplier making the same or similar products means that he or she is impacted not only during the year after termination, but potentially for several years thereafter. This is because automotive parts are often quoted on years before the actual production of the parts begins. The inclusion of a non-compete and the scope of the non-compete are risk assumption issues that the parties need to address during the negotiation process. I give my views to my client on risk assumption issues and the sales representative as the business person, decides which risks he or she is willing to take on.

If the principal insists on a non-compete provision during the post-termination period I try to limit the non-compete/non-solicitation so that it only restricts the sales representa-

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tive from going after the business already awarded to the principal. I try to avoid having the non-compete apply to new business.

My form sales rep agreement does not have a non-compete provision[1]. The primary reason for this is that sales representatives generally do not represent competing principals. This would ordinarily be considered to be a conflict of interest. A sales representative should not be in a position where he or she can influence a customer to select one principal over another for the same product. The reason for this is the possibility that the sales representative will be incentivized to try to influence the customer to select the principal that pays the higher commission rate. That would be a textbook example of a conflict of interest. Frankly, almost no buyer will want to talk to a sales representative if the buyer knows that the sales representative represents competing principals. My experience is that this situation almost never, if ever, occurs.

Gray Areas

The automotive supplier industry, like many industries, can be very specialized. My office handled a lawsuit recently where my client represented a very large machining company that specialized in manufacturing automotive parts. My client also represented another machining company that specialized in smaller more intricate automotive parts. The principal who specialized in the large parts did not want to manufacture and sell the small

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parts. The principal who specialized in the smaller more intricate parts did not have the equipment and capability to manufacture the larger parts. In this instance representing both principals was not a conflict of interest. The two principals were not competitive with each other but were in fact complementary to each other. By that I mean that representing both principals gives the sales representative more customers to call on and opportunities to quote for both principals. Representing complementary principals generally benefits both principals.

To be on the safe side, it is a good idea for the sales representative to disclose the representation of both principals and to give them both the opportunity to object. In the case mentioned above both principals consented to the representation of the other. I often advise my clients at the commencement of a relationship with a new principal to disclose to the new principal the names of the other principals he or she represents. Principals generally know who their competitors are.

The Problem at Hand

In drafting the non-compete language for the sales representation agreement I was working on, I happened to remember a problem that occurred in one of our recent lawsuits over unpaid sales commissions. In that case the principal did not manufacture products which were competitive to products manufactured by one of my client's other principals at the time the sales representation agreement was entered into. During the course of the relationship the principal decided to broaden the scope of its business and purchased new equipment. The new equipment enabled the principal to make parts competitive to parts manufactured by one of my client's other principals. Effectively, the principal created the conflict of interest by expanding its capabilities.

Sales representation agreements with non-compete provisions drafted by principals often treat violations of the non-compete provision as a material breach of the sales representation agreement resulting in lesser or no post-termination commissions[2].

During the course of the relationship the principal decided to broaden the scope of its business and purchased new equipment.

The conflict of interest created by the principal could have been a big problem for the sales representative caused by no fault of the sales representative. The conflict created by the expanded capability ended up not being a big problem in the lawsuit referred to above and we were able to resolve the dispute favorably for my sales rep client. It was, however, a good lesson for me.

The Solution

I drew on that experience in drafting the language for the new sales representation agreement that I was working on where the principal required a non-compete provision. I specifically defined the term "Products" in the sales representation agreement to be only those products being manufactured by the principal at the time that the sales representation agreement was signed. This would prevent the sales representative from being in violation of the non-compete provision if the principal later acquired the machinery, equipment and know-how to manufacture parts which competed with products manufactured by the sales representative's other principals.

The Moral

The moral of the story is that if a sales representative is in the process of negotiating a sales representation agreement and the principal insists on a non-compete provision, the sales representative should insist that competitive products be defined as the products of the principal being manufactured at the inception of the relationship. Also as noted above, it is a very good idea to include a provision in the sales representative agreement identifying the other principals represented by the sales representative with an express consent by the principal to the representation of the disclosed principals. This necessarily would require the sales representative to update the list of other principals represented anytime the sales representative signs with a new principal. It is possible that an existing principal may object when a new principal is added but it is better to find out early if there will be a problem so that the sales representative can decide it is worth it to represent the new principal. Also if possible, try to limit any post-termination non-compete provision to business previously awarded to the principal. Hopefully the sales representation agreement provided that the sales representative would be getting paid commissions on those sales.

One Last Point

It is very important for a sales representative to have a relationship with a lawyer who understands his business and is familiar with the sales representative industry. The situation described in this article is a good example of why this should be done. By the way, it might be a good idea to provide your lawyer with a copy of this article to be sure that he addresses the issue of expanded capability resulting in a violation of the non-compete provision. Also, be sure to engage your lawyer early in the process before drafts of agreements start getting passed back and forth. Otherwise, your lawyer will have a difficult time re-writing the sales representation agreement at the end of the process.

MANA welcomes your comments on this article. Write to us at mana@manaonline.org.

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[1] This is my customized version of the MANA form agreement "For Use Between Principals and Reps Selling into OEM Markets" which is a part of MANA's *Manual for the Creation of a Rep-Principal Agreement.*

[2] Please refer to the article I wrote entitled "Beware of Termination for Cause Language in Your Sales Representation Agreement" (August 2015, *Agency Sales*). As a general rule a sales representative should not agree to any language which allows the principal to terminate the sales representation agreement for cause to avoid the payment of post-termination commissions. Such language creates a high likelihood that the sales representative will be terminated for cause, justifiable or not.

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