Legal Concerns About International Distribution Contracts

by Gary Sazer and Allan Grauberd

Companies involved in exporting products frequently engage a local representative in the target market. In many cases, this is the first step in establishing a market presence and achieving market penetration. A successful distribution arrangement may continue for many years until the exporter determines that growth has been sufficient to justify a direct presence through a joint venture, subsidiary or other affiliate.

In structuring the agreement with the exporter's representative, many business and legal decisions must be made to promote a successful arrangement and to guard against the development of problems over time.

Choosing the Legal Structure

There are three principal structures:

Independent Distributor—The distributor purchases goods outright from the exporter. This structure is the simplest from the point of view of the exporter in that the exporter deals with only one entity upon whom it relies for establishing and dealing with the local market.

Sales Agent—The sales agent never purchases goods outright, but rather works on a commission basis, selling the goods on behalf of the exporter. The legal relationships of seller and buyer are directly between the exporter and the customer in the local market. Title to the goods until resale is in the exporter.

Consignment—This hybrid form is characterized by an independent party (consignee), who accepts goods contingent on its ability to sell on behalf of the exporter (consignor). The consignee has a right to return goods that it is unsuccessful in selling. Because the consignee has physical possession of the goods until resale, certain technical and legal procedures are necessary to protect the goods from creditors of the consignee.

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Exclusivity

The decision whether to grant exclusivity to a potential distributor, agent or consignee is commercially driven, and is usually contingent upon a minimum commitment by the agent, distributor or consignee to purchase or sell on behalf of the exporter, a certain volume of goods over a specific period of time. Without such a commitment, the exporter may find itself with a territory which is not productive and no possibility of altering the situation except by an economically wasteful buy-out. Even if exclusivity is granted it may be wise to limit the exclusivity so that the exporter, while prohibited from appointing other agents, distributors or consignees, retains the right to enter into the market itself.

Territorial Restrictions

Regardless of whether the sales relationship is exclusive or non-exclusive, a territorial designation limiting the representative's permitted realm of activity should be agreed to. To preserve the value of other territorial grants, adequate contractual safeguards should be incorporated to prohibit the representative from selling to wholesalers who may resell goods outside of the territory. Under certain countries' anti-trust laws, exclusive territorial grants may be problematic.

Termination

One of the most difficult areas to negotiate, especially in the euphoric stage of a new relationship, is the right of the exporter to terminate the distributor's or agent's right of representation. Most countries have laws to protect distributors or agents from having their status terminated after having invested time and money in developing a territory. The exporter seeking to ensure the right to terminate an unproductive relationship should keep the duration of the agreement as short as possible and clearly delineate events of termination. The agreement should disclaim any implied rights of renewal. Local counsel should be consulted on the proper articulation of the contractual termination clause.

Warranties

The exporter must decide what it will warrant about its products and who will be responsible for providing the warranty service—the exporter directly or the local distributor or agent. Local regulations may impose warranty obligations which may not be circumvented by the exporter. Maximum quality control and corporate image is usually best facilitated by the exporter taking charge of its own warranty obligations. Further, dependence on the distributor or agent in providing warranty service will entail complications if the relationship with the distributor or agent terminates.

On the other hand, it may be difficult in many cases to justify the investment necessary to perform warranty service directly.

A solution may be to contract with a third party, in a separate contractual relationship with the exporter, to perform the necessary service.

Shipping and Pricing

Price quotations may be subject to change based on a certain notice period. Price quotes must specify whether the merchandise is sold FOB or CIF and the location of delivery. This designation determines responsibility for insurance and shipping charges. Prices may be quoted net of any sales, use, value added taxes or other taxes and customs duties. Such charges may be imposed on the distributor or customer. Contractual provisions as to when risk of loss transfers must be articulated, e.g., upon payment, transfer of possession or otherwise. The exporter should safeguard its right to payment through a Letter of Credit, bank guarantees or other agreed security. The right to repossess goods which have not been paid for or to stop shipments of goods in the event an outstanding balance exists over an extended period of time should be reserved to the exporter.

Choice of Law and Dispute Resolution

Whose law applies and where and how disputes are to be resolved is an important contractual element. Generally, a seller will insist on its "home" law, without regard to conflicts of law principles and often excepting the United Nations Convention on Contracts for the International Sale of Goods. Disputes are often resolved by contractual arbitration in the forum of the defending party.

Avoid a Battle of the Forms

Although the exporter takes careful measures in incorporating legal provisions in its contract with its distributor or sales agent, and chooses a well drafted "conditions of sale" to accompany its shipments of goods, these precautions may be frustrated by employees of the exporter who use non-approved forms or accept non-approved forms sent by the distributor or sales agent or customer in confirming or requesting orders.

Conflicting documentation may nullify the protection built into the exporter's contractual forms. It is important to safeguard against the implication that forms or documents sent by the customer or distributor or agent will be controlling and to prevent the use of unauthorized documentation by the exporter's employees. Many lawsuits turn on the issue of what conditions have "crept" into a contract by the dispatch of conflicting forms.

Anti-Trust Concerns

Certain agreements may run afoul of various *continued on page 46*

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countries' laws concerning monopolistic practices and restraint of trade. These areas should be discussed with counsel before finalizing the terms of any representation agreement. The risks are especially relevant to larger companies with substantial volume and/or substantial market share in connection with a particular product line.

The arrangement should be terminable in the event that the control of the distributor or agent changes during the relationship, especially if the change of control is to an entity in an adverse competitive position to that of the exporter. The arrangement should also be terminable in the event that the agent or distributor falls under insolvency or bankruptcy protection laws.

In sales agency agreements, attention should be paid to whether the sales agent will be, or by law deemed to be, an employee of the exporter. Such a status would trigger numerous issues concerning labor regulations, taxation, social insurance, etc. in the sales agent's home country.

In the case of exporters involved in the sale of food products, chemicals, clothing and various other items, specific environmental, consumer safety and hazardous items regulations should be consulted.

Various devices to protect against foreign currency exchange fluctuations may be addressed where prices, for business reasons, are quoted in the target country's currency. LI

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"tame" your creditors, how to collect your receivables, and where to find assets. Bankruptcy is treated as a last resort, but fully one fourth of the book is devoted to explaining the ins and outs of this complex subject.

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