

Chapter 34

A United States Exporters' Guide to Foreign Laws Applicable to Use of Representatives and Distributors*

Research References

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§ 34:1 Checklist

- ☐ Agency vs. distributorship
- ☐ Consequences of the selection under foreign law
 - Tax effects
 - Provisions affecting termination
 - Protection of agents under local labor laws
- ☐ Management approaches to avoid or minimize problems
- ☐ Contract approaches to avoid or minimize problems

§ 34:2 In general

U.S. legal issues applicable to relationships with foreign

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sales representatives and distributors include business practices (discussed in the preceding section of this text), anti-boycott (discussed in Chapter 35), export controls (discussed in Chapter 36), antitrust (discussed in Chapter 40), and special regulations associated with exports of military products (discussed in Chapter 30).

There are many foreign legal issues which must also be considered. Certain countries, usually developing countries, require exporters to either maintain a local presence (which the exporter may be reluctant to do for tax or other reasons) or retain the services of a local representative. A number of countries have laws which regulate or otherwise restrict the use of sales representatives. In many countries, an exporter can be subject to local income taxes if its sales representation or distributor agreements are not properly structured. Additional risks may be present when the agreement is executed with a natural person rather than a corporate entity. In some countries, when a representative or distributor is retained, local law may contain impediments to the termination of such relationships or may provide for compensation to the representative based on the theory that the principal will derive future benefits from the prior promotional activities of the representative or distributor, or based on other theories. One can also encounter laws which provide that contractual arrangements with sales representatives and distributors must be governed by local law and that disputes may only be litigated before local tribunals. What steps can be taken to perfect security devices under foreign law is another subject that is relevant to dealings with overseas distributors.

§ 34:3 Questions in need of answers

Does local law permit, require, restrict, or forbid use of sales representatives?

- If permitted/required, must the sales representative be a local national? Must the agreement be registered? Are there restrictions on the rate or amount of commission? Site of payments? These are questions which must be asked in each instance.
- Are there any special restrictions applicable to military or defense products? See Chapter 30 for examples of such restrictions.
- If sales representative payments are forbidden, are there viable alternatives? Where local law forbids or restricts

compensation for order solicitation, does the law also preclude compensation for technical services? Post-sales services? Consulting agreements? Generally, bona fide approaches such as these are not precluded.

- Is the agreement that is entered into with the sales representative properly structured to avoid taxation of the exporter's sales income in the host country? The risk of local taxation is reduced if the representative is independent and the agreement expressly states that the representative does not have authority to bind the exporter.
- If an agreement is executed with a natural person rather than a corporate entity, does this present added risks associated with local income taxes? Employment related taxes? Severance of the relationship? Choice of governing law? The employment security laws of many countries are such that it is generally prudent to avoid entering into sales representative or distributor agreements with natural persons.
- Are there local laws which restrict or penalize the termination of agency or distributor agreements? Problems can include:
 - *The magnitude of the penalty*—There are many European statutes which offer severance indemnities to agents terminated without “just cause.” These indemnities can range from several months to two or three years worth of commissions the agent would earn if not for the termination. In Belgium, distributors may also be entitled to severance indemnities. Many, but not all, Central American and Caribbean statutes are especially troublesome in this respect. As an example, in Honduras, compensation to agents or distributors can include five years gross profits or five times average gross profits in contracts of less than five years, as well as other damages.
 - *Definitions of “just cause”*—Partial solutions: Where the local statute does not define just cause, define just cause in your agreement. Where the local statute defines just cause, track the language of the statute in your agreement. Example: If local law defines just cause as nonperformance of “essential obligations,” use the phrase “essential obligations” when referring to such obligations in your agreement.
 - *The ability of the terminated party to obtain injunctive relief*—E.g., in Puerto Rico, or more typically to

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otherwise delay resolution of the issues and impede the exporter's ability to set in place replacement accounts. Partial response: Where the court calendars are crowded, consider requiring local or international arbitration, when permitted.

- *Parol evidence rules.* In many of the jurisdictions in which the above concerns exist, the local statute can be called into play without evidence of a written agreement. Hence it is generally prudent to require a written agreement with such safeguards as you can include.
- Must issues which arise under agency or distributor agreements be governed by local law, or can the parties agree that the agreement will be governed by some other applicable law? Where local law is required as a matter of "public policy" (e.g., as in much of Latin America as well as in other jurisdictions), local courts will not, and U.S. courts may not, enforce any other choice of law. If the agreement provides that all disputes must be submitted to international arbitration, can such a requirement be enforced, or does local law provide that disputes may only be submitted to local tribunals? In certain (but not all) cases, such restrictions go hand in hand with restrictions on choice of law.

Are there special steps which can be taken to secure payments to exporters for goods sold to distributors? Trademark and copyright laws present other issues. Antitrust is still another legal issue that may be encountered (Antitrust issues are unlikely to be encountered when dealing with sales representatives, but in certain cases such issues may arise when dealing with foreign distributors.)

§ 34:4 **Agency vs. distributorship**

Customary distinctions between agent and distributor arrangements are:

Agent	Distributor
Legally independent of supplier.	Legally independent of supplier.

Agent	Distributor
Does not take title to goods.	Takes title to goods. ¹
Generally compensated on a commission basis.	Earnings are based on the resale margin (i.e., resale price less cost of goods sold).
Does not bear the economic risk of failure of payment.	Generally bears economic risk of sales and carries credit of customers.
Does not generally warehouse or physically distribute the goods.	Generally warehouses and physically distributes the goods.
May or may not have power to bind the supplier in contractual relationship with customer.	Has no power to bind the supplier.
Activities generally subject to considerable control by supplier.	Activities subject to minimal control by supplier.
Contact between the supplier and the ultimate customer is more likely.	Minimal contacts between the supplier and the ultimate customer.

While these general principles have considerable currency around the world, the distinction should not be treated as if it is uniformly recognized. There can also be significant local variations or melding of elements which blur the distinction between the two categories of accounts.²

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¹Sometimes, in order to secure payment by distributor, the exporter retains title to the goods.

²For example, there are “del credere” agents who guarantee the solvency of the ultimate purchaser and are responsible to the supplier for payment by him. There is also the “indent transaction” which can convert a distributor arrangement to an “agency” relationship. Another variation is the “comissionario” or “commissionarie.” Such agents (who are sometimes classified as distributors) sell in their own name for an undisclosed principal, but have more discretion under local law than would exist under a typical arrangement between a principal and an undisclosed agent.

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§ 34:5 Consequences of the selection under foreign law—Tax effects

A principal reason for doing business through a foreign agent or distributor rather than setting up a branch office or subsidiary is often the avoidance of foreign taxes. Unless care is taken in the establishment of the foreign sales relationship, however, unpleasant surprises may occur.

The key issue in most cases will be whether the relationship involves the supplier sufficiently in the foreign country to become subject to its tax laws. In most developed countries, this issue may be resolved by reference to the provisions of the U.S. Tax Treaty defining the term “permanent establishment.” In general, under such treaties, if the U.S. supplier is deemed to have a “permanent establishment,” it will be subject to foreign tax. Recent U.S. tax treaties have been based on a model tax convention developed by the Organization for Economic Cooperation and Development (OECD). OECD is a body that includes among its members those nations with the largest economies of the world.

The typical U.S. tax treaty implementation of the OECD Model Tax Convention provides that a U.S. resident is considered to have a “permanent establishment” in the foreign country if a person acting on behalf of the U.S. resident “has, and habitually exercises, . . . an authority to conclude contracts in the name of the United States resident to sell the United States resident’s goods.” Sales through an independent broker, general commission agent or any other sales agent with a genuinely independent status will not give rise to a finding a “permanent establishment” where such persons are acting “in the ordinary course of their business.”

The two principal issues of concern under the OECD definition of “permanent establishment” are:

- The degree of control by the principal over sales transactions, in which the foreign agent is instrumental; and
- The degree of independence of the foreign representative, including evidence that the representation of the U.S. supplier is undertaken as part of his normal business activities.

With regard to the first issue, the foreign agent will generally be considered not have authority to bind the U.S. supplier if each sales transaction is made subject to acceptance by the U.S. supplier at its U.S. headquarters. Concerning the independence of the foreign agent, a supplier is, in general, safer in

choosing a company rather than an individual and, to make the issue more clear, a company which also represents other suppliers so as to avoid arguments about “control in fact.”

Another danger in retaining an individual is that, unless care is taken, he or she may be deemed an employee of the U.S. supplier under the tax treaty (or applicable local tax law, if there is no treaty). When a representative is deemed to be an employee, the supplier may also be obligated to pay for prescribed pension and other social benefits and may be subject to employment security laws that may contain impediments to termination of the relationship which are more onerous than those otherwise encountered.¹ These dangers are real and need to be addressed in the decision-making process, but legal protection frequently can be enhanced by creativity in particular situations. Where counsel advises that liability to foreign taxation will probably result or that there are risks under local employment security laws, that finding must be weighed in the total business context since, notwithstanding the additional costs, the right “individual” may be able to produce spectacular results in a particular market.

§ 34:6 Consequences of the selection under foreign law—Laws protecting local representatives

Without attempting to set forth the details of particular provisions of foreign law, both agents and distributors are commonly protected in varying degrees with regard to termination of their relationship, compensation, and other social benefits. The norm for such protective legislation is that it may not be waived by agreement of the parties so that a thorough understanding of the local context will be crucial to the structuring of your agreement.

§ 34:7 Consequences of the selection under foreign law—Basic types of protective legislation—Provisions affecting termination

The most prevalent form of local protection of representa-

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¹Recent experience in Germany is that tax authorities are giving especially careful scrutiny to agreements with individual sales representatives for any indicia of “control in fact.” For the moment, however, careful drafting of the agreement with the representative along the lines indicated above still appears to avoid obligations to pay either taxes or social benefits.

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tives of foreign suppliers (whether agents or distributors) is found in the area of termination of the relationship. Typically, this legislation will require that considerable notice be given prior to termination, the agreement may be terminated only for “just cause” or a similar legal standard, and that in the absence of “just cause,” compensation must be paid to the representative upon termination. Both the notice period and the amounts payable on termination are commonly tied closely to length of service, and potential costs to the supplier may be significant. Compensation may also include one or more of the following: lost profits, capital expenditure by the representative, warehousing costs, or goodwill created for the supplier’s products.¹

§ 34:8 Consequences of the selection under foreign law—Basic types of protective legislation—Protection of agents under local labor laws

Local labor laws may also create rights for agents similar to

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¹For example, European Council Directive 86/653 of 18 December 1986 (EC) established detailed standards for the protection of self-employed sales intermediaries. In due course, each of the member nations were required to and did enact legislation providing a series of protections including but not limited to strict notice requirements for termination and indemnity for the representative if he or she brought to the principal new customers or a significant increase in sales with existing customers. National legislative actions implementing the directive include the following: Germany: October 1989 (Law dated October 23, 1989, in force since January 1, 1990); Netherlands: November 1989 (applying to agreements in force as of January 1994); Denmark: May 1990 (Law No. 272 of May 2nd, 1990); Sweden: 1991 (SFS 1991:351 amended by SFS 1998:170); Greece: May 1991 (Presidential Decree No. 219 in May 1991, modified in June 1993 by Presidential Decree No. 249); France: June 1991 (Law No. 91-593 of June 29, 1991) (implemented the directive but the legislation applied to contracts concluded after its national law and from January 1994 for contracts in progress); Italy: September 1991 (Decree No. 303 of September 10, 1991); Finland: May 1992 (Act. No. 417); Spain: May 1992 (Law No. 12 of May 29, 1992); Norway: June 1992 (Law No. 56 of June 19, 1992); Slovenia: 2001 (Slovene Legislation in Obligations Act, Official Journal of Republic of Slovenia no. 83/2001); Austria: February 1993 (Law No. 88 of February 11, 1993); United Kingdom: December 1993 (Commercial Agents Regulations, Statutory Instrument No. 1993/3053) (the regulations came into effect in January 1994); Ireland: 1994 (The European Communities (Commercial Agents) Regulations 1994 (SI No. 33 of 1994)); Portugal: April 1994 (Law No. 118/93 of April 13, 1994); Luxembourg: June 1994 (Law of June 3rd, 1994 announced in the Official Gazette on July 6, 1994); Belgium: April 1995 (Law No. 95-1481 of April 13, 1995).

those of employees in that legal system. For example, in France, the Labor Code, with attendant pension, termination, and other social benefits, is made automatically applicable to the employment of a natural person as an agent; provided however, that it must be proven that the agent does in fact have a permanent and subordinate legal relationship with the principal. In Italy also, the principal is required to pay social security on behalf of an agent and may be liable for income tax on sales made by the agent. Such protections are also common in Latin America. Potential costs involved for the supplier may be significant.

§ 34:9 Responses to issues which arise—Management approaches which may help avoid or minimize problems

Variations on the above theme are many so that it is not feasible to provide specific guidance for particular country situations here. However, a number of possible approaches may be explored in each particular case for avoiding or minimizing problems. The first and foremost recommendation is recognition of the sensitivities. This has a bearing upon the determination as to the best way to go to market; the selection process of the relationship with the local account; and the management of termination of the relationship, if and when appropriate. Where termination of the relationship is appropriate, the supplier should have a business plan for effecting the termination, with the level of required management review dependent upon the sensitivities present.

§ 34:10 Responses to issues which arise—Contract approaches which may help avoid or minimize problems

- Written Agreement and Requirement That it May Not Be Amended Without the Written Agreement of the Parties
In many jurisdictions, protective statutes can be called into play without evidence of a written agreement. Hence it is generally prudent to refrain from dealing with a local representative until you have a written agreement with its own "Statute of Frauds" and such other safeguards as you can include. Failure to heed this advice has also led to commission claims by local agents far in excess of the supplier's norm, but which may nevertheless be endorsed by local courts.

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- Release of Prior Claim
Another safeguard you should include in your written agreement is a release of all prior rights and claims. In the case of a renewal in which a representative has rights under a prior agreement (e.g., a commission entitlement), such rights should be carefully delineated.
- Fixed Term Agreements
Limitation of the term of the agreement, especially an initial agreement with an untested local representative, should be examined in relation to local law. Statutory liabilities may sometimes be avoided if the agreement expires by its own terms and is not renewed. In the case of a new representative, the initial term should be relatively short (e.g., one to two years), so that even if termination compensation cannot be avoided entirely, it should be kept within a relatively modest range. When renewing agreements, you should also be alert to the fact that in certain countries (e.g., Belgium), renewals will give rise to additional rights which did not pertain in the first instance. Similarly, in Germany, if a fixed term agreement is renewed without a clear and specific termination date, it will be treated as an agreement of unlimited term.
- Termination Notice and Repurchase of Inventories
The typical sales representative agreement (and many distributor agreements) will have a termination clause providing for immediate termination in the event the account violates certain commitments, (e.g., compliance with business practice requirements) and a specified notice period in other situations, with the length of the notice dependent upon the language of the local statute (many local laws are quite specific on this point) and the circumstances of the case. In the case of a stocking distributor, the termination clause is often accompanied by a repurchase clause. A clause providing for repurchase of inventories upon termination (usually according to a stated formula) has a two-fold advantage aside from inherent fairness. The distributor is assured of prompt payment for inventory returns, while the supplier can avoid having a disgruntled distributor “dump” his goods and disrupt the market place. Repurchase can also provide an offset for some or all of the distributor’s unpaid account with the supplier.
- Choice of Law Other than Local Law
When a representation agreement does not contain a

governing law clause, it is probable that the agreement will be governed by the law of the representative's country because that is the country in which the agreement is to be performed. If you want to attempt to change this, you may specify a different governing law in your agreement. You should be aware, however, that such a clause will often not be honored. Much of Latin America, for example, has traditionally not permitted the parties to select any governing law other than local law. Germany was previously a country which would recognize choice of law in such matters, but local law is now required to be applied as part of the implementation of European Council Directive 86/653 of 18 December 1986 (EC), *supra*. There is also a category of countries in which parties are generally free to select whatever clauses they wish in their agreements, subject to certain limited public policy restrictions (Thailand and Malaysia are examples of such countries). In other jurisdictions, any choice of foreign law will only be respected under certain circumstances, (e.g., the Philippines where, although there is no special legislation on the governing law of representation agreements, the Civil Code provides that a choice of foreign law in any agreement may only be respected if the agreement is executed in the jurisdiction whose law is to govern). In the U.S., the prevailing rule is simply that when the law of a U.S. state is selected as the governing law, that state should have an appropriate connection with the transaction. However, on occasion, U.S. courts have refused to accept such a designation of U.S. law in a sales representation agreement where this was contrary to the public policy of a foreign jurisdiction.¹

- Reference to Arbitration

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¹*Caribbean Wholesales & Service Corp. v. US JVC Corp.*, 855 F. Supp. 627, 633 (S.D. N.Y. 1994) (voiding the parties' choice of law provision because such provisions in distribution agreements are contrary to Puerto Rican law); *Pan American Computer Corp. v. Data General Corp.*, 467 F. Supp. 969, 970 (D.P.R. 1979) (holding choice of Massachusetts law in a dealer's contract inapplicable under Puerto Rican public policy; *Southern Intern. Sales Co., Inc. v. Potter & Brumfield Division of AMF Inc.*, 410 F. Supp. 1339, 1342-1343 (S.D. N.Y. 1976).); see Röhm and Koch, *Choice of Law in International Distribution Contracts: Obstacle or Opportunity?*, 11 N.Y. Int'l L. Rev. 1 (1998); King, *Choice of Law Clauses in International Agent/Distributor Contracts*, 16 International Trade L.J. 8 (1989); and Richardson,

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Consider also the possibility of including an arbitration clause. In addition to imposing severe sanctions for termination, local court procedures may permit an aggrieved agent or distributor to delay the resolution of issues and impede the suppliers ability to set in place a replacement account. Arbitration might be a way to avoid such complications though, again, the number of countries in which this option will be available for disputes with local sales representatives will probably quite restricted. Where available, however, suppliers may wish to include a carefully drafted arbitration clause in their representation agreements for a review of issues to consider when drafting an arbitration clause.

- Careful Definition of Just Cause

Legal provisions which require that “just cause” (or a similar term) be shown for termination often do not take the trouble to define that crucial term. Such an approach may be appropriate under U.S. law, but if the country is not within the common law tradition, it is unlikely that case law or other authoritative materials will shed much light its meaning. Local custom, however, may be recognized in specific local courts and must be considered in the drafting process. Careful thought should be given to those particular provisions of the agreement which, if violated, would be deemed to give rise to “just cause” for termination. Such a list might include minimum annual sales quota, minimum standards of supply of spare parts and service, change of ownership or insolvency of the dealer, nationalization, or continuation of a force majeure situation for more than a specified period. Where the local statute defines “just cause,” it is helpful to track the language of the statute when referring to this list. For example, if local law defines just cause as a nonperformance of “essential obligations,” you should use the phrase “essential obligations” when referring to identifies specific obligations in your agreement.

These and other devices may be examined in each case. In most countries a reasonable accommodation between local requirements and protection of the supplier from unreasonable or unquantifiable risks can be found. Unfortunately, there do

Choice of Law Clauses in International Contracts: Overseas Developments, 5 Canterbury L. Rev. 126 (1992) for a general review of foreign law on this subject.

exist a number of countries in which the above devices will be less effective and where the amounts of compensation payable to a terminated agent or distributor may be substantial (portions of Central America and the Caribbean are particularly difficult in this respect). In those instances, a careful look at local laws will at least provide a clear understanding of the risks involved and permit a sound business judgment.²

§ 34:11 Responses to issues which arise—Laws requiring registration of representatives or of agreements executed with representative

Local law may also require the official registration of a local agent or of the representation agreement itself. Agent registration is a common requirement in Middle Eastern countries where local law often requires that the agent be a local national or an entity owned by local nationals. In some countries (e.g., Saudi Arabia), while an agent may not be permitted on military sales, a local agent is required for other dealings with the government. In some Middle Eastern countries, the government may refuse to register a new sales representative until satisfactory resolution of any outstanding issues between the supplier and the former representative. (Generally, restrictions on the use of agents for order solicitation services do not, however, preclude bona fide technical service or post-sales service agreements).

Registration of the representation agreement may also be required to achieve protection of the suppliers' trademark under local law. Registration of the agreement with the appropriate administrative body may also carry with it a right of

²There is no substitute for examining local law on these issues and checking with local counsel to assure that materials are current. However for initial reference and summaries of local laws, the following may be helpful: Clasen, *International Encyclopedia of Agency and Distribution Agreements* (ed., Butterworth Legal Publishers) (1990); Clasen, *International Agency and Distribution Agreements Europe* (ed., Butterworth Legal Publishers) (1991); Clasen, *International Agency and Distribution Agreements North America/South America* (ed., Butterworth Legal Publishers) (1991); Clasen, *International Agency and Distribution Agreements Middle East, Africa, Asia, Pacific* (ed., Butterworth Legal Publishers) (1991); Jausàs, *Agency and Distribution Agreements: An International Survey* (ed., London: Boston: Graham & Trotman; London: International Bar Association) (1994); Jausàs, *International Encyclopedia of Agency and Distribution Agreements* (ed., The Hague; Boston: Kluwer Law International) (1997); Fremantle, *Commercial Agencies and Distributorship: An International Guide* (ed., Englewood Cliffs, NJ.: Prentice Hall Law & Business) (1992).

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review of the terms of the agreement, a factor which should be considered in the drafting process as well as in the project timetable.

§ 34:12 Responses to issues which arise—Local laws affecting compensation of the dealer

Local law may also provide specific limitations on the procedure for paying local representatives and in a few instances on the amounts payable. The key issue here tends to be the existence of exchange control regulations and the desire of local dealers to receive payment in other than the local currency or in third countries. Violation of local exchange control rules or issues of income tax evasion by the representative may be involved. As in the United States, local law may provide criminal penalties for aiding and abetting violations of local law which could have serious consequences, particularly if the supplier maintains a permanent establishment in the country or sends its personnel there on a regular basis.

Less common are local laws which place a ceiling on commissions (as in military sales to Israel or nonmilitary sales to Saudi Arabia). As of 1996, Kuwait requires that all agents' compensation on contracts with the government be disclosed and empowers the cognizant Minister to approve, reduce, or reject the compensation, after the contract is awarded. Finally, some countries require that all payments to a local representative be made through specified banking institutions in the particular foreign country.

§ 34:13 Other local laws generally

The above discussion is not intended to comprehend other areas of local law which must be examined in the process of drafting and negotiating an agency or distribution agreement. Among these, special mention should be made of trademark and copyright laws, which unless properly dealt with, can do damage to the supplier's business both in the particular country and elsewhere. Foreign antitrust issues (which may arise under distributor arrangements if the supplier has a large share of the local market, but are less likely to arise under agency arrangements) may also be relevant. Similarities in and differences between U.S. and European Union antitrust laws are reviewed in Chapter 40.

