Foreign Agents and Distributors: When and How to Use Them

by Amy L. Hirter

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When a client asks for assistance in setting up a structure to sell its goods or services overseas, it pays to be knowledgeable about the advantages and drawbacks of the various alternatives. This article assists the practitioner in identifying issues that typically arise in relationships with foreign agents and distributors.

A Colorado company planning to sell its products or services overseas normally will consult its U.S. business lawyer to determine the best method of accessing foreign markets. This article is intended to help practitioners determine whether an agency or distributorship arrangement should be used and to identify issues unique to relationships with foreign agents and distributors. The topics addressed are covered briefly, and will require further research and consideration by the practitioner.[1]

Choosing the Right Relationship

Before deciding to do business in another country through a contractual relationship with an agent or distributor, the client or practitioner probably has considered and rejected several other possibilities. These possibilities may include any or all of the following.

Direct Investment or Sales

This often is accomplished by forming an entity under the local laws of the country where the U.S. company wishes to do business, hiring employees, and establishing a place of business in that country. Direct investment allows the U.S. business to retain control over its foreign business activities, but requires a significant commitment of resources, including management long distance from the United States, placing a U.S. expatriate manager in the foreign country, or hiring reliable local management.

Joint Venture

Joint ventures can be contractual, in which each party's rights and duties are established by contract; or structural, in which a jointly owned entity is formed under the laws of the foreign jurisdiction to operate the business. In either case, a contribution of cash or other property by the U.S. venturer may be required, which can give rise to tax issues, as well as issues relating to repatriation of funds, capital registration, and currency exchange considerations. Joint venturing with a local partner has the advantage of making the foreign partner's expertise and experience in that market available to the venture, but may lead to disagreements about business strategy, cash distribution versus reinvestment, and whether new investors should be admitted. In addition, some jurisdictions prohibit a foreign entity from controlling a joint venture, particularly in sectors such as media, communications, and natural resources.

Franchising

Franchising normally entails the U.S. company licensing intellectual property

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and providing training and goods to a foreign franchisee that sells products or services under the franchisor's name and under quality standards established by the franchisor. Typically used by large retail chains, franchising is recognized by some, but not all, foreign countries as a distinct form of business relationship. If franchising is not so recognized, the relationship may be treated as an agency or distributorship, and also may be subject to intellectual property licensing laws.

Licensing of Intellectual Property Rights

Under this approach, the foreign licensee carries on its own business using intellectual property rights licensed for a specified territory by the owner of the rights. The licensor normally retains little control over the licensee's business, except for aspects related to the use and protection of the licensed intellectual property. The licensee compensates the licensor by royalties or a license fee. A U.S. licensor may find it difficult to supervise a foreign licensee's use of intellectual property without frequent on-site visits, and may encounter difficulty terminating the license if the licensee breaches the agreement.

Using an agent or distributor as intermediary instead of one of the options described above has the benefit of incorporating the intermediary's local expertise, while minimizing the U.S. company's commitment of personnel, facilities, and capital. This article focuses on situations in which the U.S. company has chosen to use an agent or distributor to carry on business in a particular jurisdiction, having rejected the other possibilities.

Distinction Between Agents and Distributors

For most purposes, a U.S. supplier's legal relationship with its intermediary likely will be determined under the laws of the country in which the intermediary provides services. The provisions of the parties' contract will influence the outcome, although the name given the relationship in the agreement will not.

Agents

An agent identifies potential customers for the supplier, handles or assists with marketing on the supplier's behalf, and obtains orders for the supplier's goods or services on terms established by the supplier. The supplier then fills the orders.

The contract of sale is between the supplier and the ultimate customer. The supplier usually retains the risk of physical loss until the goods are delivered to the customer, as well as the risk of nonpayment by the customer. The supplier often has the right to accept or reject orders, and is not contractually bound by the agent's actions (although local law may deem the supplier bound, as discussed below). The agent sometimes acts as collection agent for the supplier and may provide after-sales warranty service to customers. An agent is compensated on a commission basis and usually is subject to significant control by the supplier.

Distributors

By contrast, a distributor is the supplier's customer, periodically purchasing products from the supplier, taking title to and possession of the goods, and selling them for the distributor's own account within a defined geographic territory. The distributor generally bears the risk of being able to sell and deliver the goods and to obtain payment from the final customer. The distributor's compensation is in the form of the resale margin over the price paid to the supplier. The supplier normally retains little control over the distributor.

Defining the Relationship

A particular contract may create an agency-distributorship hybrid rather than a simple agency or distributorship, or may fit a special niche created and regulated by the laws of the host country. Regardless of the form chosen, it is essential to obtain advice about applicable local laws from a reliable practitioner qualified to practice in the country at issue.

The U.S. practitioner should keep in mind that, regardless of the legal form chosen by the parties to carry on business, under U.S. law the business relationship may be viewed differently and may produce unexpected liability for the client. For example, a person who is treated as a distributor under foreign law may be considered an agent for purposes of the U.S. Foreign Corrupt Practices Act ("FCPA").[2]

Retaining an Agent or Distributor

Before signing a contract with an intermediary, a due diligence investigation should be undertaken to determine whether the individual (or company, where corporate intermediaries are permitted) is reliable, honest, and effective. Information about prospective intermediaries may be obtained from the following sources:

- Dun & Bradstreet[3]
- Internet searches for press accounts about the intermediary
- the U.S. Embassy of the intermediary's government[4]
- international company profiles prepared by the U.S. Export Assistance Center of the U.S. Department of Commerce[5]
- the U.S. Chamber of Commerce[6]
- the U.S. State Department desk officer for the intermediary's country.[7]

When warranted by the risk presented by the transaction or the country, it may be prudent to hire an outside investigator to perform background research on the proposed intermediary.

In addition to determining whether the intermediary is likely to be successful from a commercial standpoint, the due diligence review should be designed to elicit, among other things, information that permits the supplier to establish whether there is a significant risk that the agent or distributor previously has violated (or caused its supplier to violate) the FCPA. This review also should determine whether the intermediary has a position or has family or business ties that make FCPA compliance a special concern, and whether the intermediary and any affiliates are the subject of a U.S. sanction or embargo program.

The key to the due diligence investigation is to have the "files speak for themselves" with respect to the *bona fides* of the intermediary. This means that the due diligence should be comprehensive enough, in light of the risk of illegal conduct, to present an affirmative statement of compliance in the event that the transaction is challenged under the FCPA.

Issues Common to Both Kinds of Relationships

Once an intermediary has been selected, the supplier and intermediary will document their legal relationship. The U.S. practitioner, together with foreign counsel qualified in the host country, should consider the following issues when preparing the supplier's contract with the intermediary.

Local Requirements Regarding Intermediaries

Local law may require a contract with an intermediary to be registered with a government office and, in some cases, translated into the official language of the country in which the intermediary will operate. Where both an English language and a parallel foreign language version of the contract are prepared, both should specify which version governs in case of a conflict between the two. Local law may require the foreign language version to govern. A government agency may involve itself in negotiating the terms of the agreement, even when both parties already are in agreement as to terms.

Laws requiring local registration of these agreements highlight the risk that a disgruntled competitor might use the information on file to assert that an improper relationship exists or that illegal payments have been made. If local law requires this level of transparency, it is prudent to plan accordingly when documenting the due diligence on which the client will rely.

Independent Contractor Status

Unless the terms and performance of the contract lead to a different result under applicable foreign law, both agents and distributors normally are independent contractors, rather than employees, of the supplier. However, if the supplier retains too much authority over the intermediary's performance, particularly in an exclusive relationship, the intermediary may be deemed to be the supplier's employee. That could lead to unexpected difficulties for the supplier, including responsibility for employee benefits mandated by the host country and difficulty terminating the intermediary, as well as unforeseen tax consequences.

U.S. Export Compliance

Whether goods are shipped directly to the customer or to the intermediary, the supplier must comply with U.S. export laws, including possible licensing requirements.[8] Technology and goods exported from the United States remain subject to U.S. regulation regarding re-export from the receiving foreign country to another country. The laws in this area are premised on changing views of national security and foreign policy. It is recommended, therefore, to consult counsel experienced in this practice area to avoid costly missteps.

Exports requiring licensing can occur in unexpected ways. For example, exports include the transmission of know-how by methods such as electronic communication, shipment of training manuals, making information available for computer downloading outside the United States, and classes or product demonstrations conducted abroad by U.S. persons. Exports can occur when information is transmitted within the United States if the recipient of the information is not a citizen, permanent resident, or political refugee.

Generally speaking, certain products and technology are not permitted to be exported, and others may be exported only to certain countries. U.S. laws particularly restrict the export of products and technology for specified end-uses including encryption, nuclear activities, and weaponry.[9]

Exports to certain persons and entities are prohibited or restricted altogether.[10] After the terrorist attacks of September 11, 2001, the list of entities that cannot receive exports originating in the United States has grown exponentially. A common error is to assume that a client's technology does not require licensing if it is strictly commercial in nature. That is a dangerous assumption that can lead to significant penalties under export control laws.

Import Compliance In the Host Country

The other side of the export coin is compliance with the laws of the foreign country regarding the import and sale of the supplier's goods or services. This responsibility can be allocated to the intermediary under the contract with the supplier. However, the supplier is well advised to consult local counsel to verify host country requirements.

Compliance with U.S. Sanction and Embargo Programs

The supplier will be responsible for determining that its activities and those of its agents comply with the U.S. government's numerous sanction and embargo programs.[11] Historically these were directed at nations—such as North Korea and Iraq—that presented national security risks. The prohibitions have grown, however, and can affect commercial transactions that on their face are appropriate. Absent appropriate controls, a client can find itself inadvertently dealing with a denied party, designated terrorist-supporting entity, or international narcotics trafficker, in violation of U.S. government sanction and embargo programs.[12]

U.S. Anti-Boycott Laws

In any cross-border transaction, including one with an intermediary, a U.S. entity or individual may encounter a request to cooperate with a boycott of a country that is friendly to the United States. Participation by a U.S. entity or individual in such boycotts is illegal.[13] Illegal requests may be veiled, for example, as a requirement to certify that parts do not originate in a particular country or that controlling officers of the U.S. company are not nationals of that country, or as a request for information from a boycotting country about the company's business.

U.S. anti-boycott laws and regulations prohibit U.S. persons from, *inter alia*, complying with or supporting such a boycott by refusing to do business with a boycotted country and discriminating against U.S. persons and their affiliates based on race, religion, sex, or national origin; furnishing information about such persons' race, religion, sex, or national origin; and furnishing information about the company's business relationships with a boycotted country, in each case with the intent to comply with or support a foreign boycott.[14] U.S. persons and entities are required to report requests to comply with or support an unsanctioned foreign boycott. A failure to report as required can result in significant penalties.

Intellectual Property Licensing

When trademarks or other intellectual property rights are licensed to a foreign agent or distributor for purposes of marketing or selling the supplier's products, attention should be given to local licensing requirements. These may include restrictions on exclusivity and terminability, updating requirements, and statutory damages payable on improper termination. Certain countries assert the right to approve license agreements and may cap royalty payments and impose significant withholding taxes on royalties.

Normally, the supplier will want to clear and register its trademark or service mark before licensing it to an intermediary or contractually prohibit the intermediary from registering the mark. The supplier also should consider including in a license agreement grant-back provisions that permit the supplier to use translations, modifications, and improvements created by the intermediary, to the extent permitted by local law.

Data Privacy and Anti-Spam Laws

Many foreign jurisdictions, including countries that are members of the European Union, have more stringent data privacy requirements and prohibitions against unsolicited electronic communications than does the United States.[15] The collection, storage, processing, and use of personal data may be prohibited. Situations such as software distributorships in which the ultimate customer is registered with the supplier and arrangements in which the supplier or its intermediary sends electronic communications to customers or prospective customers can give rise to data privacy issues and prohibitions on sending unsolicited e-mail without the recipient's consent. Depending on the country, the laws may protect entities, as well as natural persons.[16]

Convention on the International Sale of Goods

If the countries in which the parties have their places of business, as determined under the United Nations Convention on the International Sale of Goods ("CISG"),[17] are both signatories to the CISG, the convention will apply to their cross-border sale of goods transaction unless it is contractually excluded.[18] The provisions of the CISG should be compared to laws that would apply if the CISG were excluded to determine whether the parties want their contract to be subject to the CISG and whether they wish to apply the CISG with certain derogations or variations.

De Facto *Contracts*

U.S. lawyers often assume that a contract is not formed until it is executed and delivered. However, particularly in civil law jurisdictions, a *de facto* contract can be deemed to exist without a signed document, and sometimes without a written instrument having been drafted. Local counsel should be consulted during the early stages of negotiations to determine if this might occur in the country concerned, as well as whether a principal could be bound by its agent's actions in the absence of a signed contract.

Force Majeure *Considerations*

Most contracts between a supplier and an intermediary will contain a *force majeure* clause describing the situations in which the parties will not be responsible for a failure to perform in accordance with the contract provisions because of events beyond their control. Due to the possibility of changes in government relations and policies, care should be given when drafting a *force majeure* clause in a contract with a foreign intermediary to provide that the U.S. supplier will not be liable for the effects of action or inaction by a foreign government or government instrumentality.

Governing Law and Dispute Resolution

A U.S. supplier probably will want to select the law of a U.S. state to govern the contract with its intermediary. However, in many foreign jurisdictions, that choice of law (particularly in an agency contract) will be unenforceable and the law of the intermediary's domicile must be applied. Even if the foreign country permits U.S. law to apply, the jurisdiction may have mandatory laws that cannot be escaped by contract.

Although U.S. arbitral awards likely will be enforceable abroad if the United States and the other country involved both are parties to a treaty or convention providing for enforcement of foreign arbitral awards,[19] the enforceability of a U.S. court judgment against a foreign intermediary probably will be subject to principles of comity and public policy of the country in which the intermediary resides. Remedies such as injunction and specific performance may not be available in other countries or may be more difficult or time-consuming to enforce. Practitioners should remember that a contractual choice of foreign laws will have no impact on the application of certain U.S. legal requirements, such as those found in the FCPA and U.S. export control laws.

Foreign Antitrust Principles

Contract provisions such as exclusive licenses, establishment of exclusive sales territory, non-compete clauses, and restrictions on a distributor's resale pricing may be regulated by antitrust laws in the intermediary's home country. Those laws may prohibit certain provisions or require clearance from the antitrust authorities in advance.

Packaging and Labeling Requirements

Laws of the host country and conventions to which the United States and the host country are parties may include particular requirements with respect to packaging and labeling of the supplier's product, including placement of trademarks. The intermediary may be given contractual responsibility to ascertain and communicate to the supplier such requirements, but ultimately it is wise for the supplier to verify them with experienced U.S. and local counsel.

Issues Relating to Foreign Agents

Several issues typically arise in connection with a supplier's relationship with a foreign agent. They are discussed briefly below.

Regulation of Agents

Some countries recognize more than one type of agent, with specific requirements or restrictions applicable to each.[20] Agents may be required to be citizens of the country in which they act as representative and to register with a government office.

Termination of Agents

Two aspects of an agency relationship most commonly regulated by foreign law are the ability of the principal to terminate the arrangement and the compensation that must be paid to the agent on termination. If the contract initially is for a relatively short term and does not renew automatically on expiration, the principal is more likely to be free to terminate the agent without serious repercussions. Many countries impose obligations on the principal to compensate an agent whose contract is terminated, often based on the length of the term for which the agent represented the principal, the amount of money the agent invested in developing the business, and the goodwill created by the agent. Other countries impose mandatory notice periods prior to termination becoming effective. Such compensation and notice protections often cannot effectively be waived by the agent.

Non-Competition After Termination

Some countries have statutes that limit any non-compete covenant that survives termination of the agency relationship as to geographical scope, duration, and the universe of products covered by the covenant. The parties usually cannot vary the effect of those provisions by contract.

Scope of Agent's Authority

Limitations on the agent's authority to bind the principal by executing sales contracts or order forms should be clearly established in the contract between them. In addition, local law should be checked for provisions allowing the agent, notwithstanding contractual limitations imposed by the principal, to bind its principal to agreements with third parties. The supplier's counsel also should ascertain whether the agent's representations to customers constitute warranties by the principal.

Foreign Corrupt Practices Act

The FCPA[21] is designed to prevent bribery of foreign officials and politicians by U.S. businesses and to require accounting records to be maintained that allow the U.S. government to verify whether bribes are being paid. The FCPA broadly proscribes payments, gifts, offers to give anything of value, and authorizations of such gifts to foreign officials and politicians to influence their actions in an official capacity or to secure an improper advantage to obtain or retain business.[22] Employees and agents of "domestic concerns," as defined in the FCPA,[23] are subject to the antibribery provisions even if they are not U.S. citizens or residents.

Payments, promises of payment, and authorizations of payment to any person, including an agent or distributor, while knowing that all or a portion of the value will be used directly or indirectly to bribe a foreign official or politician, also violates the FCPA.[24] Awareness of a high probability that an intermediary is paying bribes in connection with the supplier's business is considered "knowing." Requests by an intermediary for extra compensation, for payments to be made in cash or to an account in a third country or in a nominee's name, and requests for reimbursement of undocumented expenses should be treated as red flags that merit investigation by the supplier to determine whether the agent is paying bribes.

The supplier should have a compliance program in force that enables it to identify and address any FCPA issues before becoming subject to the FCPA's criminal and civil penalties. Such a program should include the following:

- consideration of how an agent's proposed compensation compares to that of similar agents in the same country
- the intermediary's representation in the contract that he or she understands the FCPA
- the intermediary's agreement to refrain from making prohibited payments or offers and to report any requests for bribes immediately in writing to the principal.

The contract also should include:

- a representation by the intermediary that he or she is not a foreign official or politician (or, in the case of a corporate intermediary, that it is not owned or controlled by such a person) to whom payments are regulated by the FCPA
- periodic certification requirements regarding the intermediary's FCPA compliance
- a contractual right of the supplier to terminate the contract immediately for cause if the intermediary violates the FCPA or does not provide the required certifications.

It is vital for the supplier to educate its employees and intermediaries about the FCPA and to constantly be aware of the intermediary's actions. If the supplier is an issuer of securities registered under the Securities Exchange Act of 1934,[25] it should ensure that its accounting records comply with the FCPA's recordkeeping provisions.[26]

Issues Relating to Foreign Distributors

A U.S. supplier's relationship with its foreign distributors may present several issues that are unique to distributorships. Some or all of the following issues may arise in those agreements.

Exclusivity

The supplier often will want its distributor to sell only the supplier's products, rather than acting as distributor for a number of suppliers. However, in some jurisdictions exclusive distribution contracts may violate antitrust laws because they are deemed to limit free competition. Local counsel should be consulted to determine the acceptable parameters of any exclusivity clause under the laws of the host country.[27]

Payment Methods and Currency Conversion

Suppliers often want their distributors to make payments in U.S. dollars, thus shifting any currency exchange risk to the intermediary. Assuming that is permitted at the time the contract is signed, unforeseen events, such as a liquidity or monetary crisis in the distributor's home country, could cause that to be impossible, requiring remedies such as a back-up plan for exchange of the foreign currency into a third currency that is convertible into U.S. dollars or the accrual of interest to compensate the supplier until payments can be made in U.S. dollars. A letter of credit confirmed by a U.S. bank acceptable to the supplier often resolves the payment concerns, because the confirming bank's obligation to pay the supplier will depend only on the presentation by the supplier of specified documentation.[28]

Duration and Termination

If the parties continue to perform a fixed term distribution contract beyond its stated term, it may be treated by local law as having indefinite duration. That could give rise to indemnities or damages payable by the supplier on termination of the distributorship.

Statutory Warranties

Many countries impose warranty provisions by statute. For public policy reasons, such warranties often cannot be limited or waived. The supplier may require its distributor to maintain a product liability insurance policy issued by a carrier approved by the supplier in a specified amount, naming the supplier as an additional insured. The distributor also may be contractually required to indemnify the supplier for liabilities arising from the sale or use of the supplier's products by the intermediary.

Conclusion

Agents and distributors can make valuable contributions to a Colorado company's overseas business strategy. Suppliers choosing to retain agents and distributors must take care in selecting them, negotiating contracts with them, and monitoring ongoing compliance and business results. The assistance of knowledgeable U.S. counsel and advice from foreign counsel are critical to successful business relationships with foreign inter mediaries.

NOTES

1. Bilateral or multilateral conventions and treaties between the United States and the intermediary's country may affect a number of the issues outlined in this article, and must be considered as each transaction requires. Also, although tax planning is an essential part of structuring a cross-border business relationship, a discussion of relevant tax issues is outside the scope of this article.

2. 15 U.S.C. § 78m and 78dd-1 to 78dd-3.

3. Dun & Bradstreet is accessible online at http://www.dnb.com/us.

4. *See* U.S. Department of State website, http://usembassy.state.gov (provides links to websites of U.S. Embassies, Consulates, and Diplomatic Missions).

5. The U.S. Department of Commerce is accessible online at http://www.commerce.gov.

6. The U.S. Chamber of Commerce is accessible online at ttp://www.uschamber.org.

7. The U.S. Department of State is accessible online at http://www.state.gov.

8. These include the Arms Export Control Act, 22 U.S.C. §§ 2751 to 2799aa-1; the International Traffic in Arms Regulations, 22 C.F.R. §§ 120 to 130; and the Export Administration Regulations, 15 C.F.R. §§ 730 to 774.

9. 15 C.F.R. § 744.

10. 31 C.F.R. Chapter V, App. A.

11. Some of the sanctions and embargo programs are embodied in the International Emergency Economic Powers Act, 50 U.S.C. §§ 1701 to 1707; the Trading with the Enemy Act, 50 U.S.C. App. §§ 1 to 44; the Cuban Democracy Act, 22 U.S.C. §§ 6001 to 6010; the Foreign Asset Control Regulations, 31 C.F.R. Chapter V; and in related Executive Orders.

12. 18 U.S.C. § 2339B; 15 C.F.R. § 744.12–744.14; 31 C.F.R. §§ 595.311, 536.311, and 597.

13. The primary concern is the Arab League boycott of Israel; however, any unsanctioned boycott can present problems.

14. 50 U.S.C. App. § 2407; I.R.C. § 999; 15 C.F.R. § 760.2.

15. *Cf.* Directive on the protection of individuals with regard to the processing of personal data and on the free movement of such data, Commission and Council Directive 1995/46, OJ (L 281/31) (Nov. 11, 1995); Directive on Privacy and Electronic Communications, Commission and Council Directive 2002/58, OJ (L 201/37) (July 31, 2002).

16. A European Union directive on electronic commerce also requires suppliers of "information society services," including the sale of goods online, to provide certain information to their customers, such as their address, registration information, and a description of any supervisory authority. Directive on electronic commerce, Commission and Council Directive 2000/31, OJ (L 178/1) (July 17, 2000).

17. Convention on Contracts for the International Sale of Goods ("CISG"), 19 I.L.M. 671 (April 11, 1980).

18. *Id.* at Art. 6.

19. Examples of such conventions include the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 21 U.S.T. 2517 (June 10, 1958); and the Inter-American Convention on International Commercial Arbitration, O.A.S.T.S. No. 42 (Jan. 30, 1975).

20. For example, the European Union has issued a directive to its member countries requiring them to adopt legislation closely regulating commercial agents, including the duties of the agent to the principal and of the principal to the agent; default remuneration provisions; notice requirements for termination; and compensation for the agent after termination. Council Directive 86/643, OJ (L 382), 17-21 (Dec. 31, 1986). In implementing the directive, each member country is free to derogate from certain of the directive's provisions.

21. FCPA, *supra* note 2.

22. 15 U.S.C. § 78dd-2(a).

23. FCPA, *supra* note 2.

24. 15 U.S.C. § 78dd-2(a)(3); *In the Matter of GE InVision, Inc., Exchange Act Release*, 2005 WL 354585 (2005); *Securities and Exchange Comm'n v. GE InVision, Inc.*, No. C-05-0660, Lit. Rel. No. 19078 (N.D.Cal. 2005); *Securities and Exchange Comm'n v. Titan Corp.*, No. 05-0411 (JR), Lit. Rel. No. 19107 (D.D.C. 2005).

25. 15 U.S.C. §§ 78a *et seq.*

26. 15 U.S.C. § 78m.

27. In the European Union, exclusivity between a supplier and a distributor is regulated by means of a directive that establishes a block exemption for certain provisions and prohibits others. Commission Regulation 2790/1999, OJ (L 336) 21-25 (Dec. 29, 1999).

28. Parties to a transaction that involves an international letter of credit often choose to incorporate the Uniform Customs and Practice for Documentary Credits, 1993 Revision, ICC Publication No. 500, into their agreement to govern that portion of the transaction. ■