Many U.S. exporters use foreign sales intermediaries to penetrate foreign markets, occasionally in combination with foreign branches or other affiliates of the exporter. This article will explore a number of traps for the unwary and other important considerations in foreign sales intermediary contracts.

Distributor and commission agent relationships are common, but the nomenclature and legal attributes of each varies considerably among countries. Generally, distributors buy and resell the supplier’s goods or technology, bear the economic risk of resale to at least some extent, profit by a mark-up on the goods, and may or may not stock inventory. In contrast, commission agents do not take title to the goods and instead earn commissions on specified triggering events (commonly, acceptance of a qualifying order), may or may not bear the risk of collection (payment timed with collection from customer), and may or may not have the authority to accept orders or take other binding action for the principal.1

The attributes of a given relationship in a foreign market may differ even under the above terminology, when duties or rights associated with a true agency relationship in the United States apply. In some foreign markets, the terminology used to refer to the relationships may differ, and there may be a variety of specific sub-classes with distinct nomenclature and legal consequences.2

A decision to utilize a sales intermediary is often based on commercial considerations, but legal concerns may be paramount. Success in a market requires extensive knowledge of industry practices, culture, and language; visibility to and ready access by prospective customers; perceived commitment to the market and ability to provide post-sale support, and; existing relationships with prospective customers and other parties in the channels of commerce and, as applicable, regulatory offices.

Sales intermediaries are often perceived as fulfilling these market essentials while limiting capital investment; leveraging an existing sales network, which is especially valuable when complementary goods and services offered in the intermediary’s line card offer competitive advantages for the U.S. exporter; avoiding delays associated with establishing and staffing a foreign enterprise; avoiding liability for local income taxes, social welfare programs, and other local costs; avoiding restrictions in debt covenants regarding new subsidiaries or other affiliates by the U.S. exporter, and; mitigating risks.

In many cases, legal considerations may prove paramount. In some markets, local representation is required to supply goods or services in the local market.3

Legal considerations may also dictate which sales intermediary structure is most advantageous to the exporter in a market. Although freedom of contract is the norm in the United States for business-to-business relationships, Virginia and other states regulate some relationships or industry sectors when policy considerations justify encroaching on freedom of contract. For example, Virginia restricts termination and mandates other contractual rights for sales intermediaries of heavy equipment,4 beer,5 and wine.6

The statutory or common law rules of many other countries mandating contractual rights in sales intermediary relationships can be traps for unwary U.S. exporters. Many of Virginia’s top
export destinations have such national protectionist regimes.

**Agents are afforded substantial protection under national laws more frequently than distributors.**\(^7\)

In such cases, counsel should consider whether a distributorship approach or consulting relationship will be best for the client. The distributorship alternative may be encouraged by terms that implement a risk and compensation structure close to an agency relationship, such as no inventory stocking requirement, local buyer payment risk mitigation measures, and pass-through warranties from the exporter to the local buyer. A consulting relationship may also be a viable alternative, with bonuses to supplement modest base compensation terms and duties that support and facilitate the order process as opposed to obligating the consultant to procure orders. Alternative structures may still trigger local protectionist laws under a substance-over-form analysis or by analogy by local tribunals.

**Protectionist terms vary considerably among countries, but frequently include the following common mandates:**

- **Minimum advance notice prior to termination,** the length or applicability of which may depend on whether the contract has a stated term or is indefinite in duration, and the number of years the relationship has been in existence. For example, European Union commercial agency contracts not having a stated term require a one-month notice for each year from commencement, up to a total of three months, and member countries are allowed to lengthen this period by one month for each additional year up to six.\(^8\)

- **Restrictions on termination (including in some cases, refusal to renew for an additional term):** Notwithstanding clear language in the contract to the contrary, many countries impose a cause requirement for termination of a sales intermediary relationship,\(^9\) especially on indefinite term contracts,\(^10\) and in some cases, even on non-renewal of a stated term relationship.\(^11\) Although often perceived by U.S. exporters as minimizing exposure, even in jurisdictions lacking a mandated cause requirement, indefinite term relationships are prudent because of the risk of cause requirements being implied by communications, other course of dealing, or by a hostile local forum. Quotas and other objective performance criteria integrated with the specific cause requirement of local law are especially important to include when possible.

In the international context, suppliers must administer the contract with an eye toward enforcement. Instead of routinely and informally forgiving non-fulfillment of quotas or other terms, a written amendment reciting the extenuating circumstances or other factors for the excuse in a specific case and affirming their intent to honor these terms in future periods should be used. A form from counsel for this purpose delivered with the draft contract may minimize the “runaway client” syndrome that too often occurs.

**Post-termination compensation:** Termination of an indefinite term relationship, and in limited cases even refusal to renew a stated term intermediary relationship, without sufficient cause can give rise to substantial post-termination compensation liability in many markets. In some markets, even an intermediary terminated for cause is still entitled to compensation.\(^12\)

The scope of compensation and the extent to which exposure can be readily quantified at termination varies considerably. For instance, EU agents must be paid an equitable indemnity based on new customers or increased volume attributable to the efforts of the agent as well as damages based on costs incurred in performance and other lost expectancy elements.\(^13\) While the potential exposure is often difficult to quantify even on the date of termination, some markets provide formulas to measure or cap an intermediary’s entitlement.\(^14\) Contractual formula with reference to the local legislative requirement may provide more certainty.

**Avoidance Strategies:** Can these burdens be avoided?

**Choosing an Unprotected Structure,** such as a distributorship or consultancy approach in an agency-only protectionist regime can be effective, subject to the caveats noted above.

**Choice of favorable law clauses are common,** however, the protectionist laws generally prohibit abrogation, even in countries that otherwise would respect a contractual choice of law. Coupling a favorable choice of law with a requirement for arbitration outside of the local market is
Clients are often surprised that U.S. export laws regulate even domestic conduct of U.S. companies that do not deal directly in other countries.

Compliance with export controls, anti-corruption and other regulations must be integrated. There are many compliance considerations applicable to sales intermediary relationships. The direct and indirect expense of investigative and enforcement proceedings can be crippling, even if no violation occurred or the client is not culpable for violations. The frequency with which U.S. and foreign companies require that suppliers have effective internal compliance programs as a condition to their relationship is increasing. Thus, proactive counsel is vitally important. Although a meaningful discussion of compliance mandates is beyond the scope of this article, the following concepts are important:

Practical strategies to ensure compliance begin with due diligence and extend through contract administration. Due diligence regarding the commercial suitability of prospective intermediaries is important, but thorough due diligence as to compliance issues is also essential. Imbedded relationships of the intermediary may themselves represent or cause violations, and past conduct can give rise to potentially disastrous public relations problems and market interruption. In addition, systematic and documented due diligence may be an effective defense or at least a mitigating factor against penalties should violations involving the intermediary. Screening questionnaires and consultations with compliance counsel should occur at the outset.

In addition, even sophisticated intermediaries often don’t know how to facilitate compliance by their U.S. supplier. Moreover, intermediaries are more prone to resent and perhaps even circumvent supplier compliance efforts if they do not understand the applicable laws, the dedication of the U.S. supplier to compliance, and the potentially staggering consequences to the supplier and the intermediary of non-compliance. Therefore, education of the intermediary is vitally important.

The contract itself should not only evidence compliance due diligence and enforcement by the exporter, but should also educate the intermediary. Affirmative representations by the intermediary and compliance mandates with a mechanism for updating compliance duties are fundamental. Providing the intermediary with written compliance policies and practical steps to ensure compliance during performance may prevent violations, or at least insulate the U.S. supplier from later liability. Finally, an internal written compliance program that integrates effective administration of intermediary contracts is essential.

U.S. Export Controls are among the issues that an effective intermediary contract must address. Clients are often surprised that U.S. export laws regulate even domestic conduct of U.S. companies that do not deal directly in other countries. The conduct of U.S. parties directly exporting or supplying for the purpose of export, as well as their foreign intermediaries, is regulated to an even greater extent. For example, to protect national security and implement economic sanctions programs, U.S. parties, and in some cases even their foreign affiliates, are prohibited from directly or indirectly supplying goods or technology to embargoed destinations or destinations to which an export license is required, engaging in transactions with parties that are subject to denial orders for violations of U.S. export controls or who are listed on an applicable controls list due to other actual or suspected misconduct, or supplying for prohibited end-uses. In addition, enabling a foreign sales intermediary to circumvent these controls, whether intentionally or by failing to exercise due care to detect and prevent such activity, will represent a violation by the U.S. party. Anti-diversion clauses and duties to gather and supply accurate end-user and other information to the supplier are thus essential in intermediary contracts.

The U.S. Foreign Corrupt Practices Act (FCPA) and foreign anti-corruption laws must be effec-
tively addressed in the contract. Vigorous recent enforcement of the FCPA’s prohibition against bribing foreign public officials is augmented by the growing number of foreign anti-corruption initiatives, such as the Organization for Economic Co-Operation and Development (OECD) Anti-Bribery Convention and the national laws that have resulted, such as the U.K. Bribery Act which proscribes bribery even among commercial parties.

The screening questionnaires advocated above should query current and former public offices and relationships among intermediary staff. The contract should at a minimum prohibit intermediary conduct that the supplier cannot undertake directly and require prior public office may present compliance challenges for the supplier. Advance written approval before entertainment of or travel with public officials related to supplier’s business interests should also be considered.

*Competition laws* are increasingly relevant in foreign intermediary relationships because of recent vigorous and coordinated global enforcement initiatives, even in traditional cartel markets, such as Japan. The approaches noted above are important in this context as well.

*A failure to plan is certainly a plan to fail in the sales intermediary context.*

Endnotes:

1. Acceptance of an order in the local market may subject the U.S. supplier to income tax liability there.
2. France and Kuwait for example.
7. For example, under European Council Directive 86/653 for the harmonization of commercial agency laws (ECC 86/653), EU member countries must legislatively extend specified minimum standards of protection to commercial agents in respect to their activities in the EU. No such mandate exists in respect to distributorship relationships, and Belgium is the only EU country known to the author that has legislated similar generally applicable protection to distributors. See, Law of July 27, 1961, as amended by the Law of April 13, 1971 concerning the unilateral termination of exclusive distribution agreements concluded for an indefinite duration.
9. Brazilian Commercial Representative Law 4,886/65 for example.
10. ECC 86/653 for commercial agents in the EU and national implementing legislation for instance.
11. Puerto Rico’s Dealers’ Law, Act. No. 75 of June 24, 1964 and Law 21 of 1990 require “just cause” for termination or refusal to renew distributorship and agency agreements, respectively, for example.
12. For example, Brazil Law 4,886/65 mandates every terminated agent be compensated for loss of expectancy based on average commissions paid and the number of months remaining in the term.
14. ECC Directive 86/653 provides that indemnity cannot exceed the equivalent of one year’s remuneration based on the average of the past five years or shorter period of the relationship, while Brazil Law 4,886/65 requires payment of the average monthly compensation multiplied by one-half of the remaining months of the term or 1/3 of the commissions payable in the preceding three months of an indefinite term agency.
15. See New York Convention Article V(2)(b); Accentuate Ltd v Asigna Inc. EWHC 2655 (QB 2009) (English High Court allowed an English reseller to proceed with civil process against the Canadian supplier seeking compensation via litigation in England under its commercial agency regulations despite their agreement designating Ontario law as governing and requiring arbitration in Toronto, as well as prior arbitral rulings adverse to the terminated English reseller).
16. For instance, access by a foreign national in the U.S. to controlled technology is deemed an export under U.S. Export Administration Regulations, 15 CFR § 730, et seq. (EAR) and the International Traffic in Arms Regulations, 22 CFR §§ 120, et. seq. (ITAR).
17. See, e.g., Iran Threat Reduction and Syria Human Rights Act of 2012, signed into law by President Obama on August 10, 2012.
18. See, e.g., EAR Parts 738 and 746, 15 CFR § 738.1, et. seq. and 15 CFR §746.1
19. User-friendly links can be found at http://www.bis.doc.gov/complianceenforcement/liststoscheck.htm
21. Adopted by 34 OECD member countries and 5 non-member countries (Argentina, Brazil, Bulgaria, Russia, and South Africa).

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