

USING FOREIGN DISTRIBUTORS FOR YOUR PRODUCTS

There are many ways for you to get your products into a foreign marketplace. The most common are:

1. Selling to a U.S.-based buyer who then handles the export of the product;
2. Licensing certain rights (trademark rights or manufacturing rights, for instance) to a foreign person, who then makes/sells your product in a foreign market and pays you a percentage of the sales;
3. Having an agent line up customers in a foreign country, for which you pay the agent a percentage of sales;
4. Selling directly into a foreign marketplace, either through case-by-case inquiries from buyers, via website orders or by maintaining an office in a foreign location; or
5. Using a distributor in a foreign location.

This article is part of a series on Doing Business Overseas. In it, we will focus on the issues commonly discussed and negotiated with foreign distributors. Specifically, the intent of this article is to focus on the “big picture” issues that define your distributor’s conduct and, by extension, your company’s goodwill in a foreign market.

Defining the “Distributor”

In its simplest form, a distributor is a foreign person or company to which you sell your products, with the expectation that the distributor will then resell those products within a foreign territory. Unlike an agent who typically works on a commission basis, a distributor buys and owns your products for some period of time (in some cases, a distributor will own and warehouse your products; in others, a distributor will own your products for only a fraction of a second). You are paid by the distributor when they buy your product, and they, in turn, are generally free to negotiate their own terms with their customers. In any event, customers in the foreign market will soon associate your products with your distributor. So it is critical that you 1) carefully select your foreign distributors, and 2) outline, in writing, specific expectations that you may have for them.

There are, of course, many reasons why careful investigation of a potential distributor is a good idea. Some countries make getting rid of an underperforming distributor difficult. Some distributors may require an exclusive market – putting “all of your eggs in one basket.” And some distributors may lose focus on your product and spend their energies on other, even competing, products. When working with a foreign distributor, it is also important to make sure that your distributor arrangement will not impute an employer-employee relationship with your company, possibly triggering tax and other unintended consequences. Your investigation of a potential distributor should not only examine the individuals acting as a distributor, but also their prior performance history, possible competing products they have carried in the past, the nature of any legal entities the distributor proposes to work through, and the local laws of the territory regarding distributor relationships.

Following are six broad inquiries you should undertake regarding distributors for your overseas product sales.

Define the Distributor's Territory

First, you will need to carefully define the distributor's territory – and whether your distributor has exclusive or non-exclusive rights in that territory. Related to this issue, you will also need to assess whether the distributor currently markets any potentially competing products; in most cases, you should attempt to prohibit the distributor from competing with your interests in that territory if local laws permit such a restriction. It is also almost always critical to provide a finite term for this contractual relationship. These types of agreements can certainly be extended, and many are. But it is almost always advisable not to create a perpetual “evergreen” distribution arrangement in a foreign market.

Determine Desired Level of “Goodwill”

Second, you should carefully determine how much “goodwill” you wish to pursue in the foreign market. Can the distributor stick their label on top of yours? Do they have to mention your company in connection with the particular product? How do they market and describe your product, and do you want to have the ability to review marketing and sales literature before distribution of same? If you will let your distributor use your trademarks or trade names, you should take time to define how and when they can use those marks. Also, be upfront about what type of information you believe is confidential to your company.

Monitor Markets

Third, it is common for the parties to a distribution agreement to require the distributor to monitor the foreign market for 1) competing products; 2) factors that may affect product sales in the market; 3) intellectual property infringement; and 4) other product sales leads. If you would like your product to appear at a certain price point in the foreign market, you should examine to what extent that is permitted in that particular country. In some jurisdictions, you are limited in your ability to dictate a resale price for the product that is owned by your distributor. You should always include some self-serving language in any distribution contract that requires the distributor to comply with all local laws applicable to your product and to obtain all governmental consents related to the importation and sale of your product in the territory. Make sure your distributor is aware of your product warranties, and discuss how warranty claims, if any, will be handled in the foreign market.

Define the Terms of Sale

Fourth, it is imperative that you define the precise terms of sale of the commercial relationship between you and your distributor. When and how will product ship (and who will be responsible for insuring shipments)? Are partial or deferred shipments possible? How much does the distributor need to buy from time to time in order to maintain exclusive distributor status? When and how can you change product prices, and what are the normal payment terms? Note that there are a number of different ways to be paid in foreign transactions. (This is the subject of another article on Terms of Payment; please contact our firm with any questions you may have.) It is also a good idea to carefully define who in your company can accept purchase orders, and vice versa. Maintaining a “real time” dialogue with your distributor is critical in foreign commerce. Do not just sign up a bunch of distributors and then cede markets and market information to them.

Understand the Market

Fifth, you will want to allocate company resources to learn about the marketplace from your distributor. What product changes might appeal to that market? Are there other product opportunities? In so doing, you will also have a chance to assess your distributor's performance: Are their books accurate? Are they conducting themselves in a responsible manner (*i.e.*, are they insured, handling customer/warranty

complaints in a timely manner, not exposing your company to liability and taxes in the foreign market and generally representing your company in the best possible light)?

Have a Transition or Exit Strategy

Finally, if things do not work out to your satisfaction, you will want to be able to move on to other product sales and distribution options, or to cleanly exit that market. Again, in certain markets this will be easier than in others – you should be aware of your alternatives at the time you negotiate a contract with your distributor, not when it comes time to part ways. A properly drafted distribution agreement can ease your transition to another distributor option or to a quick exit from an unprofitable market.

The intent of this article is not to discourage you from participating in the global marketplace. Rather, it is our hope that this article will serve as a starting checklist of discussion points as you engage with potential distributors for your products.

Should you have matter-specific questions – or any questions about “going global” in general – please do not hesitate to contact our law firm at any time.

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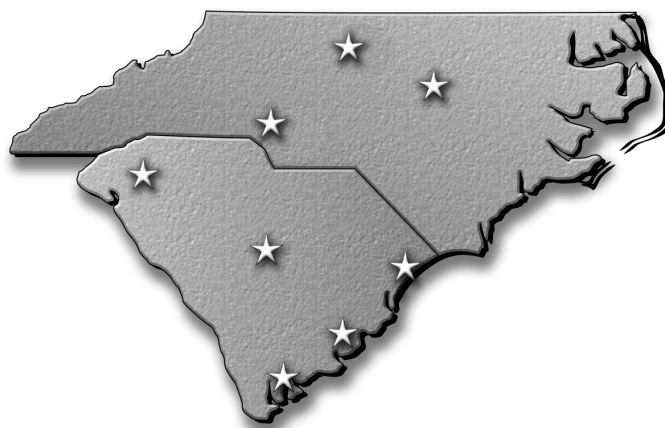
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