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# DISTRIBUTION CHANNELS IN THE UNITED STATES OF AMERICA:

# AGENT OR DISTRIBUTOR?

**Avv. Daniela Morrison**[1]

Many foreign companies wish to establish a commercial presence abroad, especially in the United States of America. The first thing that comes to mind is how to establish a presence and ensure that products are distributed in the United States in an efficient way, i.e., with the least expenditure of money. The exporter may use intermediary channels of distribution, such as an agent or a distributor if (i) the exporter is not financially strong to form and maintain a subsidiary or (ii) he prefers to confirm the level of acceptance of the new product abroad before establishing a permanent presence. The agent or the distributor, as the case may be, will market the products according to the terms and conditions agreed with the exporter.

The terms of agent and distributor are often used interchangeably, but there are differences. This article explains the differences between a distributor and an agent in the United States of America and the essential terms that should be part of an agreement regarding distribution through those two channels.

## *I. Agent*

Whether it is an individual or an entity, the agent is a representative[2] of the exporter and its activity is aimed at promoting and soliciting the sale of the exporter's products in a defined territory. In most cases, the exporter directly handles and concludes the sales that the agent solicited. The agent is solely responsible for the promotion and sale of the products, and does not provide after sales services, which remain a responsibility of the exporter. The agency arrangement allows the exporter to have greater control and supervision on the marketing of its products because the exporter has direct contact with the final customers.

The agent is paid a commission calculated on the sales concluded between the exporter and the customers. In addition, the exporter uses the market knowledge of the agent to monitor the promotion of its products.

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[2] The agent can be either an employee of the exporter or an independent contractor.

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***Expressed or Implied Authority***

Since the agent represents the exporter in the promotion of the products, a bona fide third party may see the agent as an alter ego of the exporter with the ability to create a contractual relationship between the exporter and the third party. That implies that any action or decision that the agent takes automatically binds the exporter under the principle of expressed or implied authority. To avoid unpleasant surprises, it is recommended that the contract clearly describes the agent's duties and actions that the agent can take on behalf of the exporter. Also, it is recommended that the exporter reserves the right to approve or decline sales negotiated by the agent before a contract is signed with the customer.

It is necessary that the contract between the exporter and the agent is in writing because the principle of authority referred above is implicit even in the absence of a written contract. The advantage of having a written contract avoids misunderstandings as to the type of the agent's activities capable of binding the exporter.

***II. Distributor***

In a distribution relationship, the distributor only purchases the products from the exporter and re-sells them to customers. The products become part of the distributor's inventory. The distributor, not the exporter, has a direct contact with the customers.

The distributor is a separate entity and does not depend on the exporter. In fact, the distributor does not represent the exporter and the principle of expressed or implied authority does not apply here. Thus, the distributor cannot contractually bind the exporter with third parties. In addition, the distributor is responsible for providing the after sales services. Generally, distributors bear the marketing and advertising costs.

The main disadvantage for an exporter in a distribution arrangement is the impossibility to monitor and check that the products are distributed throughout a given territory. That is because the exporter does not have a direct contact with the customers. In addition, distributors tend to re-sell the products at higher prices than those "suggested[3]" by the exporter in order to make a profit between the price paid to the exporter and the sale price charged to customers.

[3]The term "suggested" is used rather than "imposed" for antitrust reasons.

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On the other hand, the advantage is that the exporter receives payment for its products from the distributor and does not have to chase down various customers for payment. Obviously, that is an advantage as long as the distributor pays for its purchases timely.

### *III. Important Contractual Terms*

- **Territory**: The agency or distribution agreement must identify the territory assigned to the agent or the distributor, as the case may be. Distributors and agents often request exclusivity in the territory assigned to them so that they are the only agents or distributors operating in that territory for the distribution and promotion of the products. Exclusivity is a very sensitive topic and should be considered only if the exporter knows the distributor well and can reasonably rely on its distribution network. In addition, for the sake of avoiding issues in the event of a termination, it is good practice to tie the exclusivity to annual minimum purchases requirement, as mentioned below.

- **Term**: The initial term should not be too long, especially if the exporter offers exclusivity. That is because the parties cannot know at inception whether the relationship will be successful. The agreement should not renew automatically, and the achievement of the annual minimum purchases requirement should be a condition precedent to the renewal.

- **Minimum Purchases Requirement (distributor)**: If exclusivity is granted, it is suggested setting annual minimum purchases requirements for the distributor with a termination provision that gives right to the exporter to terminate the agreement with cause if those minimum purchases are not met. If a contract provides for exclusivity without requiring minimum purchases it is more difficult for an exporter to terminate the agreement without consequences. In fact, the distributor could sue the exporter alleging that the contract was not a distribution agreement, but a franchise in light of the costs that the distributor incurred and paid to the exporter for the marketing and distribution of the products under the exporter's trademark and name. Generally, courts are likely to lean toward the distributors.

- **Exporter's Right to Distribute the Products**: The exporter should reserve the right to distribute and promote the products directly in the territory assigned to the distributor or the agent. Customers sometime prefer to deal with exporters directly.

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- **Payment Terms**: Payment terms must be clear.
    - In the case of an agent, it is important to clearly describe in the agreement when the commission is earned.[4]
    - In a distribution arrangement, a distributor tends to request long payment terms, such as 90 or 180 days, for various reasons: for instance, distributor does not receive timely payments from the customers, or it offers installment payment plans. Because exporters mostly sell to distributors on credit, it is suggested including language granting a security interest in the products through the filing of a *UCC-1* to guarantee payment.

- **Products**: Each distribution and agency agreement should list the products that the distributor or agent will be distributing or promoting, as the case may be. Generally, the products are listed in an exhibit to the agreement. If the exporter has different lines of products, it is suggested listing the line of products contemplated in the agreement, specifying that the products not covered under the agreement are excluded and will be marketed by the exporter directly or through other distributors and agents in the territory.

- **Trademarks**: Exporter should grant to the distributor or agent a license to use the exporter's trademarks. If the exporter has not registered its trademarks in the United States it should do so a soon as possible to avoid that third parties register the trademarks before the exporter.

- **Insurance**: It is normal practice to require that the distributor and the agent have commercial general liability and workers' compensation policies in place.

- **Confidentiality Agreement and Non-Compete**: During the agreement, both distributor and agent will have access to exporter's confidential information, such as customer lists, prices, and marketing strategies. Distribution and agency agreements should have confidentiality clauses for the protection of such confidential information.

  The exporter my request that the distributor or the agent do not sell or promote products of exporter's competitors, especially, if exporter offers exclusivity[5].

[4] For instance, the right to payment of a commission is triggered when the customer purchases the products and pays the exporter.

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- **Termination**: The agreement should be clear on the termination provision. If termination is for good cause, the agreement should describe clearly the situations that constitute cause for reasons of termination. For instance, failure to reach the minimum purchases requirements constitutes cause for reasons of termination.

***IV. Agent or Distributor?***

Exporters often debate whether they should use an agent or a distributor. There is no certain answer. There are various factors to weigh in making the decision:

- The authority principle that applies in an agency arrangement;
- Size of the market;
- The nature of the products;
- The level of control that the exporter wishes to keep in the marketing of the products.

Before making any decision, the exporter should conduct preliminary marketing research to confirm local practices in the geographic territory in connection with the products.

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Our Firm may assist you in the preparation and negotiation of agency or distribution agreements. Questions or requests for additional information may be sent to daniela.morrison@vallalaw.com

This article covers in general terms some aspects of agreements with agents or distributors, and is not intended in any way to constitute legal advice and does not create an attorney-client relationship.

[5] It is worth noting that if the agent is an individual, classified as independent contractor and not as an employee of the exporter, some problems may arise. In the event agent suspects that the exporter is about to terminate the agreement, the agent could complain that it was not an independent contractor, but an employee because of the exporter's control on the agent's activities, and could sue the exporter. The exporter could be exposed to tax penalties, both at a federal and state level in the event the suit is in favor of the agent.