The International Distribution Agreement

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Practical Approach to Transnational Contracting across the European Union, the United States and Latin America

Marco Mastracci

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The International Distribution Agreement: Practical Approach to Transnational Contracting across the European Union, the United States and Latin America

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Preface

Professor Marco Mastracci's latest work is the result of extensive studies at the highest level and many years of experience in the sector. It is an extremely relevant piece of work that also provides practical guidance for practitioners and lawyers active in commercial law and who approach the complex subject of international distribution contracts.

In a context of mounting protectionist pressures and crises in multilateral trade governance, the International distribution agreement takes on a central role. However, it continues to stand today as an atypical case, which the jurisprudence often fails to frame, sometimes comparing it to the "framework agreement" scheme, or associating it with a "mixed contract".

At an international level, the discipline of the distribution contract is further fragmented, making Professor Mastracci's work even more precious.

In this work, he analyses and resolves, in a punctual and shrewd way, the challenges potentially faced by young people and even the most experienced lawyers, providing a clear, concise and functional framework of best practices to build up a distribution contract with countries outside the European Union.

In this particular in-depth study, in which the specific peculiarities of transnational contracts in the areas of the EU, the United States and Latin America are addressed, the author provides an excellent resource that provides practical indications with a solid theoretical basis, which can provide a point of reference on the matter for all commercial law professionals.

Fabio Massimo Castaldo
Vice-President of the European Parliament

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CHAPTER ONE

Introduction

1.1 THE DISTRIBUTION AGREEMENT IN A CROSS-BORDER CONTEXT

The following pages will examine the different sources of law that affect—or may affect—the regulation of cross-border distribution contracts.

The ever-increasing interconnection between markets, businesses and individuals from all over the globe has reduced the barriers to the international exchange of goods, capital and services: this has led to the emergence of an ever-increasing series of international and transnational transactions, which, being based on contractual arrangements, need adequate regulatory coverage.

The subject will be examined in light of some preliminary considerations, according to which the international distribution contract should not only be considered as a mere legal phenomenon but as an instrument that implements and regulates economic transactions, whose extent and quantity allow to describe this contractual scheme as particularly relevant in cross-border transactions.

The different legal sources that will be dealt with in this introductory overview will be then contextualized by referring to the functionality that they show, both from a strictly legal point of view and with reference to the legal system to which they belong, and from a functional point of view, i.e. evaluating their ability to provide an adequate response to the needs of international markets.

The problem of the adequacy of the regulatory sources arises in particular when referring to commercial contracts: the specific nature of the commercial discipline is given by the fact that this matter is

influenced by many factors such as, among others, contract laws, market regulation, and competition. Furthermore, international transactions require specific rules to deal with events that typically occur in international trade, such as the need to obtain a license for the import or export of goods.

The specificity of the subject is one of the reasons why legislative coordination of international commercial law would be desirable. In addition, another factor to be considered when dealing with a transaction on the transnational level is the fact that several countries (and different municipal legal systems) may be involved in one international commercial transaction: rising the problem of the so-called "conflict of laws", i.e. the problem of establishing which set of laws is actually applicable to the transaction.

In the lack of a general, international discipline for the international distribution agreement, the identification of the applicable law consists in the identification of the municipal laws that will govern the contract. Such identification may either be carried out by the parties during the negotiation or, by the interpreter, through the application of the criteria established by "private international law". In both cases, it represents an essential passage to achieve the correct interpretation and execution of the contract, because the parties' agreement needs to be coordinated with a set of laws, in order to achieve enforceability.

Once the conflict of laws is solved, the contract results definitively regulated by one national legal system. It follows that the enforceability or otherwise of the contract, as well as more generally its validity and ability to guarantee the fulfillment of the obligations contained in it, will be regulated by the national law of a certain State: this represents an element that requires particular attention, not only because it is necessary to have a good knowledge of the discipline set by the national system with reference to contracts and more generally to all the elements that will be involved in the transaction, but also because it is necessary to analyze the possibility of obtaining—and effectively enforcing—a sentence (or, if applicable, an arbitration award) in the event of default.

An alternative to the application of laws aimed at solving the conflict of laws, and more generally to the need to identify a national legal system as a law governing the contract, would be the possibility to refer to a system of trans-national laws, applicable indifferently in all States as

a reference discipline for a certain type of transaction. In other words, an adequate response to the needs that arise together with the increasing international transactions would be the unification of commercial law.

This unification could take place through procedures aimed at integrating the national legal systems, i.e. through the preparation, by means of instruments of cooperation among the States, of common principles or rules: this mechanism, which operates at the level of public international law, has led in fact to the unification of individual sectors or individual types of transactions related to the international trade, that are now regulated by international conventions.

In this way, the principles established uniformly at the international level are applied to the international contracts regulated by the convention, being the international laws incorporated into the (municipal) regulatory system governing the contract.

Unification by means of international treaties for the coordination of legal systems, however, is a fragmentary process, capable of providing for uniform rules which are limited to certain types of transactions; moreover, international conventions have shown a limited ability to adapt to the continuous development of international trade: in a context such as that of globalized markets, which is characterized by rapid and continuous changes, the need to update the rules would emerge continuously, not aligning with the amount of time required by international law for the amendment of the conventions.

Another method to achieve the unification of international commercial law is to follow an a-legislative way, that is to say by resorting to common principles generally applied in commercial operations: parallel to what happens on the level of public and private international law, international trade operators have started to develop their own uniform rules applicable to international transactions.

This led to the elaboration of general contract conditions, codes of conduct, contractual models adopted globally by the various professional and business associations on the basis of current commercial customs and concerning specific types of commercial transactions.

In summary, the system of sources that regulate international commercial contracts is particularly complex, involving international rules, municipal laws and a-legislative systems (that include general principles, collections of uniformly accepted collection of terms and particularly widespread contractual standards): in each of these ways, the

objective to be achieved is to foster a greater level of legal certainty in order to facilitate the conduct of cross-border business relations.

Applying what has been said so far to the case of the international distribution contract, it is possible to outline the system of sources that regulate—or can regulate—its provisions. Being the distribution agreement a contractual scheme that in most legal systems is not directly regulated by a statutory discipline, the application of the municipal law of a State requires a very accurate analysis of such legal system. The task of the drafter—or interpreter—of the international contract is made even more complicated by the lack of a uniform discipline of international commercial law that can be applied to this matter.

For this reason, as long as it is not possible to achieve a complete unification of international commercial law, it is essential to achieve a good familiarity with the multiple instruments that are available during the negotiation and interpretation of the international distribution contract. Knowledge of the aims limits of each type of regulatory source involved allows in fact to make better choices regarding the applicable law, which will have effects on all the fundamental aspects of the agreement, due to the necessary coordination between the clauses and the normative frame in which they are set.

1.1.A The distribution agreement

Generally speaking, the distribution contract can be defined as an agreement under which the *supplier*, or the *manufacturer*, or even another *distributor* undertakes to sell certain goods to a *distributor,* and the *distributor* undertakes to market such goods within a certain territory, in order to sell them to his clients.

Therefore, it is evident that through the distribution agreement the parties agree on the conditions and modalities of the future sales of the goods that will be supplied by the supplier to the distributor.

However, the distribution agreement is not simply an agreement on future sales: it instead constitutes a long-term relationship between the parties, aimed at placing the supplier's goods on the market. In fact, the purpose of distribution is not simply the purchase of goods by the distributor, but the subsequent distribution of these within a market, normally corresponding to a certain territory.

The distribution contract must therefore regulate all those aspects that are closely linked to the distribution process and which may

include, for example, the use of a certain brand, the training of the distributor's employees, after-sales assistance and advertising. of the supplier's products and/or brand within the target market.

In addition to these essential operational matters, the parties may agree on several other clauses that will tend to characterize the relationship in more detail, such as an exclusivity clause, or a non-competition clause, or any other clauses the parties may agree on. In some cases, the law itself requires the inclusion of certain contents in the contract.

Looking at the supplier's obligation individually, we note that the supplier undertakes to sell certain products to the distributor; this means that with the distribution contract the parties set in advance some of the most important elements concerning the purchase and sale contracts that will take place subsequently between supplier and distributor. In this sense, the distribution contract is often defined as a "framework agreement", which constitutes the basis on which the parties will carry out the individual sales among themselves through the order procedure, which in subsequent sales will have the function of an offer, and the order confirmation, which will instead represent acceptance.

As far as the obligations of the distributor are concerned, these consist overall in placing the supplier's products on a certain market. This obligation may include several specific agreements regarding the methods, times and limitations of the placing of products, as well as, for example, the provision of after-sales assistance services, agreements relating to advertising campaigns, or even staff training.

1.1.B The cross-border context

Like any other agreement, the distribution contract is classified as "international" when there are elements of some importance that involve the jurisdiction of a State other than that of the other elements: this occurs, for example, when the parties are established in different States, or even when the parties agree that the distribution of the products shall take place within a State other than that in which the parties are established.

The transnational character of a relationship produces a series of not negligible effects on the contract that regulates it. The most important of these effects concerns the identification of the sources that govern the international contract. In fact, while domestic law contracts

are governed by the national law of the state to which they refer, international contracts can be governed by different types of laws, both national and international.

A contract is a voluntary, deliberate, legally binding and enforceable agreement, that creates mutual obligations between two or more persons or entities (the "parties").

It is "voluntary" and "deliberate", because the contractual bound is created by the parties, who also set their mutual obligations. It is worth emphasizing that the agreement reached by the parties is valid if—and to the extent that—it includes those elements that are necessary in order to make it "legally binding"; finally, a contract is "enforceable" when it can be enforced in a court of law.

This definition of "contract" highlights the close connection between the obligation created by the parties and the legal framework in which the obligation exists: an agreement can be considered as "valid" and "enforceable" as long as it adheres to the basic requirements set by the law.

In addition to defining the essential requirements of the contract, the law can intervene in different ways on the contents of the agreement, such as including implying terms into a contract, guiding its interpretation or determining the cancellation of clauses that are contrary to mandatory rules.

An example could clarify the extent of the impact of the law on the content of the contract.

In Singapore, section 14 (2) of the Sale of Goods Act states: *"where the seller sells goods in the course of a business, there is an implied condition that the goods supplied under the contract are of satisfactory quality"*; in other words, every contract for the sale of goods, which is referred to goods that are sold in the course of a business, and is regulated by the laws of Singapore, will include the provision about the "satisfactory quality" of said goods, with the consequence that if the goods supplied under a contract in the course of a commercial activity are not of "satisfactory quality", the buyer will be able to sue the supplier for breach of contract.

More generally, the law that governs the contract not only sets the basic requirements for the enforceability, validity and existence of such contract, but is also able to provide for the so-called implied terms, that are included in the contract, whether the parties agree on such terms

or not. The law that governs the contract can also regulate the consequences that derive from a breach of contract provisions.

Therefore, even the most detailed and complete contract must be coordinated with the law that governs it.

In this light it becomes clear that, in order to exist and produce concrete legal effects, the contract must be placed into a defined regulatory context, without which it would only be a dead letter: *"A contract is the creature of its proper law, and it is a reference by the parties to a system of law which is to give life to the contract"*.[1]

When the parties of the agreement are subjects of the same legal system, and the agreement takes place within the territory of the same State, the contract is subjected to the municipal law of that State. In this case, both parties are likely to have some familiarity with the legal framework of the contract: they can move with confidence on the negotiation of the clauses, and are able to foresee the consequences of the fulfillment or not fulfillment of the obligations contained in implied or expressed clauses.

On the other hand, an international contract, which regulates a cross-border relationship, requires the resolution of some preliminary issues related to the objective difference between the context of international law and the legal context to which each party normally refers.

Taking a further step in the previous example regarding the rules regulating the sale of products in Singapore, it will be possible to highlight some of the major issues related to international law contracts. In the context of an international transaction related to the sale of goods between a Singaporean party (buyer) and a non-Singaporean party (seller), it would be of crucial importance to establish whether section 14 (2) of the Sale of Goods Act of Singapore is applicable or not to the international contractual relationship. Generally speaking, if the law governing the contract is that of Singapore, the protection

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[1] Roland Brown, 'Choice of law provisions in concession and related contracts' *The Modern Law Review* 39.6 (1976): 625–643 (hereafter *Brown, Choice of Law*) Furthermore, an example of this position is given by Lord Wilberforce in the (UK) case *Amin Rasheed Shipping Corporation v Kuwait Insurance Company* [1983] UKHL J0707-2, [1984] AC 50, in which the judge had the opportunity to stress that the proper law of the contract is *"the law which governs the contract and the parties' obligations under it; the law which determines normally its validity and legality, its construction and effect, and the conditions of its discharge."*

tool provided for in section 14 (2) will be effective and the provision regarding the quality of the products will operate as an implied term, producing an impact on the international relationship. In the event of a default, or if the products prove to be of poor quality, the buyer may request to the competent court the application of section 14 (2). Of course, it will be necessary first to identify which court is competent to judge this dispute, and then to face all the difficulties of a case, amplified by the typical factors of transnational relations, such as, for example: the interpretation of the contract, the linguistic differences, the different rules on the evaluation of the evidence. Finally, once the court's sentence has been obtained, it is necessary to verify whether this sentence can be effective in the territory of the State in which it should be executed.

In general, the contract which establishes and regulates a transnational relationship adds a number of supplementary issues to those normally involved in a national contract. This further complexity, which characterizes international contracts, is a direct consequence of the fact that each State has its own laws, which may differ from those of the other States.

Having highlighted the general link between the contract and the legal framework in which it exists, it is clear that, given the autonomy of each State in setting the content of its laws, the same contract can have different effects if it is governed by the laws of one State or another.

We defined the distribution contract as the contract by which a subject, the "distributor", assumes the obligation to autonomously and independently promote and commercialize products or services supplied by another contracting party, the "supplier". This notion, which however is widely shared also at the international level, derives mainly from the practice of commercial relations and from the jurisprudence of the courts:[2] in fact—a part from limited exceptions[3]—the fundamental structure of the distribution

[2] Cristina Pellisé de Urquiza, *Los Contratos de distribución comercial: problemas de derecho internacional privado en la Comunidad Europea* (Bosh, 1999) p. 28.

[3] It is worth pointing out that some States are provided with rules that specifically apply to the distribution contract: for example, Belgium provides, in its legal system, a regulation that offers specific protection to the distributor when this presents certain requirements. However, if this approach is an exception to the common practice, it is equally true that any company wishing to distribute its products on the Belgian market should take this into due consideration of the *1961 Act on unilateral termination*

agreement is not completely defined or regulated by specific laws neither at the level of national law nor at the international level.

The lack of a univocal definition[4] of this contract means that the concept of "distribution" can be variously interpreted, either on in a more restrictive perspective or, on the contrary, through broader interpretations of the basic concepts that compose it. The broad concept of "distribution" includes various contractual arrangements, such as agency, mediation, brand license and supply; instead, a more rigorous approach would require to clarify what are the obligations that characterize the relationship one intends to indicate when referring to the distribution contract.

So, we refer to the most rigorous interpretation of the concept of distribution when we define this relationship by highlighting the characteristics that allow it to be distinguished from those types of relationships that can be considered as other ways to achieve a form of "distribution in the broad sense".

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of exclusive and quasi-unilateral distribution agreements concluded for an indefinite term. The Belgian Distribution Act offers substantial protection to the exclusive Belgian distributor, considered as the "weaker contractor" of the agreement, especially with reference to the eventuality in which the supplier decides to unilaterally terminate the agreement for any cause other than the serious misconduct implemented by the distributor. Likewise, Lebanon and some countries in the Middle East and Latin America also specifically regulate the distribution contract through national legislation that is particularly favourable to distributors; In Lebanon, commercial representation agreements are governed by Decree-Law No. 34, of August 5, 1967, which defines the persons and entities subject to its provisions and provides them with certain legal advantages with respect to the applicable law, and the courts having jurisdiction over the disputes that may arise from the commercial representation agreements; A degree of distributor protection similar to that provided by Lebanon can also be found in Bahrain, Jordan, Kuwait, Oman, Qatar, and the United Arab Emirates; in Saudi Saudi Arabia and North Yemen the protection of the distributor is provided by different normative sources, such as the practice and the custom; finally, in other Middle Eastern countries, legislation is less restrictive. As far as Latin America is concerned, an example of protective regulation can be found in in Brazil: the national legislation provides that the agency and distribution relations are governed by a regulation that is distinct from the one that regulates a sales representation relationship. Moreover, some member countries of the European Union (Germany, France, for example), not providing a specific regulation for the distribution contract, in many cases apply analogously the legal provisions on the commercial agency contract.

[4] *See infra, Chapter 2.*

For example, to emphasize the difference between the distribution relationship and the agency relationship, the independent nature of the distributor is normally underlined pointing out that in the distribution agreement the supplier undertakes to supply certain products to the distributor and, at the same time, the distributor undertakes to purchase, distribute and promote these products in its own name and on his behalf. In addition, it is worth pointing out that the obligation on the distributor corresponds to its right to distribute the supplier's goods or services to customers and consumers, normally with reference to a certain territory: this places the distributor in a privileged position compared to that of the commercial operator who only carries out sales transactions on his account, precisely because the supplier can grant exclusivity to a distributor within a certain territory.[5]

One of the most important aspects that distinguishes the distributor from other similar figures is the business risk that the distributor undertakes by purchasing and reselling the products at his own risk and at his own expense: in fact, the distributor is not remunerated by the supplier and acts as an independent merchant.

Normally, the distributor is a person who is familiar with a single market of interest of the supplier: this favors the entry and circulation of goods into different territories through multiple distributors, each of which will operate in a specific area; moreover, the possibility of setting up a commercial distribution network using independent distributors can represent significant benefits for the producer also because the risks of export operations are shared with the individual distributor precisely because the latter acts autonomously and independently from the supplier. This is one of the main reasons why the distribution contract constitutes a particularly widespread instrument in international trade.

As we have said, the main objective of the distribution contract is to facilitate the entry and circulation of goods on international markets, establishing a connection between the production of goods or services and the final consumer: which, conversely, is equivalent to defining the distribution contract as the instrument through which products are made available to end consumers located in different geographical areas.

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[5] Fiorelli, G. Dorio. "Contratti internazionali di distribuzione: problemi di legge applicabile e di giurisdizione." Rivista di diritto internazionale privato e processuale (2007): 633.

In these terms, it is evident that the distribution sector plays a fundamental role in the diffusion of goods and services and, consequently, in the development of commercial exchanges.

On the other hand, in most legal systems the distribution contract is considered an atypical contract, i.e. a contract that is not the subject of a specific and exhaustive statutory discipline.

From a point of view closely linked to national law, and therefore referring to distribution contracts that take place entirely within the territory of one State, jurisprudence and doctrine can be essential tools for reconstructing important aspects of the relationships that are created and regulated by this type of agreement; from the international point of view, the tools available to the interpreter are essentially similar to those available under municipal law, but with the further complication brought by the fact that, in the absence of uniform discipline at the transnational level, the interpretation of the contract will have to take into account the different regulations operating in different legal systems.

Earlier in this paragraph, we noted that the close connection existing between the contract and the law is shown by the general definition of contract, which ultimately states that there cannot be a contract in the absence of a law that governs it.

Making a further step from the same premise, it is now necessary to highlight the functional aspect of the contract. the function of the contract is to bind the parties to their mutual promises, providing for tools capable of protecting the non-defaulting party, in the event that the other does not comply with its obligations.

From this point of view, it is clear that the contract is not merely a legal phenomenon, but rather an instrument under which certain effects are materialized in the context in which the parties live, exist and operate.

The discipline that regulates international contracts has been largely influenced by technological developments and by the political, social and economic events that have involved the different regions of the globe: today's world, which is made up of geographical areas that can communicate in real-time, exchanging data and information as well as goods, services, and capital, is a network of transnational legal relations.

If technological development can be seen as a determining factor in the formation of the *"demand"* for the protection of international business transactions in terms of law, on the *"response"* side to this need it is necessary to consider the political factor, both from the point of view of internal policies and from the standpoint of the International Community.

The States can adopt common strategies, agreeing on the objectives, timing and contents—or at least the essential elements—of the policies they intend to implement with reference to a certain sector or a certain issue. The cooperation among the States, which is fostered by International Organizations, represents a characteristic trait of our age and shows that the modern International Community is rewriting a new concept of "sovereignty," which tends to be more efficient in providing for concrete answers to the needs and interests of the subjects, of people, of businesses.

In fact, on the ashes of the Second World War, the States laid the foundations for the development of an international network to support the development of economic trafficking (for example, the establishment of the GATT and subsequently the World Trade Organization).[6] It is worth pointing out that, at present, most of the municipal rules concerning trade are fostered by—bilateral or regional—international agreements such as the numerous agreements stipulated in the WTO, the agreements governing the European Union's internal market and the hundreds of bilateral agreements on the movement of goods.[7]

However, international cooperation can be achieved with varying degrees of intensity: a national policy of greater or less openness to cooperation, as well as the choice between the implementation of liberal economic policies or the preference for more protectionist strategies, can be seen as signs of the willingness of a State to develop, or not develop, common strategies on an international level, and/or clues regarding the level of integration that the State is prepared to reach within the International Community.

It has been said that, in general, our times are characterized by important examples of cooperation among States, that in many cases

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[6] Folsom, Ralph H., et al. International business transactions: a problem-oriented coursebook. ThomsonReuters, 2012. (hereafter Folsom et al., International Business Transactions)

[7] Folsom et al., *International Business Transactions* pp. 337 et seq.

are reached through the instruments developed by International Organizations.

Such examples of cooperation between States may have played a role in the increase of commercial relations between companies located in different areas of the world; or, on the other hand, cooperation between States may have been encouraged by the prospects for economic growth. Either way, it is entirely plausible that these two phenomena are somehow related, and that the development of international commercial relations has given rise to a demand for new tools of legal protection, applicable to the new transnational commercial networks. In other words, cross-border commercial relations—and the corresponding cross-border contracts—should be regulated in a way that can effectively bind the parties to their obligations, providing for effective remedies in case of default.

In particular, the intensification of relations between commercial entities located in different countries, fostered by what, starting from the Second World War, appears as the new structure of an international community more inclined towards cross-border collaboration, has brought to light the need to identify innovative tools or mechanisms,[8] that aim to guarantee an appropriate legal coverage for the transactions carried out in a growing network of transnational trade.

This need has, in fact, gradually emerged in relation to the objective difficulty of regulating matters concerning relationships that involve centers of interests rooted in different countries, and characterized by non-homogeneous cultural contexts and different legal experiences. In this context, the international contract[9] is no longer considered as a

[8] In the present discussion, the terms "tools" and "mechanisms" are used with a precise meaning: with the term "tool" we want to indicate the reference to an imperative, to a command or to a guideline aimed at regulating a given subject; with the term "mechanism," on the other hand, we intend to indicate, more generally, any means used to achieve a specific objective.

[9] For a complete and widely shared definition of the concept of "international contract", see UNIDROIT Principles of International Commercial Contracts with Official Commentary [1994] (49–50) "*The international character of a contract may be defined in a great variety of ways. The solutions adopted in both national and international legislation range from a reference to the place of business or habitual residence of the parties in different countries to the adoption of more general criteria such as the contract having "significant connections with more than one State," "involving a choice between the laws of different States," or 'affecting the interests of international trade'* ".