



## **Busy Executive Guide: Sales Representative and Distributor Agreements**

### **Introduction**

In this fast-paced world of lucrative international deals, busy executives with a firm understanding of core legal issues enjoy a competitive advantage. AbdulJaami, PLLC's "Busy Executive Guide" series provides decision-makers with the information they need to understand key legal issues and know when to call in back-up.

This report is the first in the "Busy Executive Guide" series. The report focuses on core legal issues that impact the negotiation of sales representative and distributor agreements. It is presented as a case study in question and answer format. After reading this short report you will have a good understanding of (1) the laws that impact sales rep and distributor agreements, (2) key differences between the two types of agreements, and (3) how you should negotiate so that you keep the dollars rolling in and leave the headaches to your competitors.

### **Background**

Arvind, the owner of a India-based company that manufactures electronic equipment, is eager to boost sales in the United States. Arvind is currently negotiating with Joe, a United States citizen, who says he can help Arvind gain a strong presence in the U.S. market. Arvind conducted due diligence and concluded that Joe's claims are legitimate. Now Arvind and Joe, eager to begin generating sales and making profits and commissions, are about to sign an agreement. Arvind's cousin Niraj told Arvind about a website where he could buy a sales representative agreement for \$10 and save a bundle on legal fees. Arvind bought the contract, but after reading it, is not sure that it will protect him. He approaches AbdulJaami, PLLC, a law firm that advises on international commercial transactions, and tries to figure out whether it makes sense to spend \$500 or so for Mr. AbdulJaami to review his \$10 agreement.

Below are the questions that Arvind asked and the answers that he received:

**I bought a sales representative agreement online seems to cover everything that I can think of. Will having a lawyer review it do anything to help better protect my business?**

Arvind, the agreement that you bought online may do exactly the job that you want it to...but then again, it may not. You will not find out until you are in court or at the arbitration table; either way you will be spending money that you could have saved.

Yes, by having a lawyer review your agreement you will have a better idea of how the law impacts your business relationship with Joe. You will be able to take advantage of law that may give you a benefit and protect yourself from laws that may result in you incurring additional costs or increased risk.

At the very minimum, to protect your business, you should have a lawyer review the agreement you purchased online. Relying on an agreement that you purchased online and didn't have a lawyer review, is like buying a used car without either test-driving it or having a mechanic take a look. Everything may turn out just fine, but if there is a problem, you will not find out until something goes wrong.

Here is how to conduct a basic analysis of the agreement that you purchased online:

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- In general, does the agreement apply to your particular situation?
- Were the facts that led to the creation of the agreement similar to the facts that impact your contemplated business relationship?
- Are there issues, unique to your situation, that should be reflected in the agreement? If so, are they?
- Laws are jurisdiction specific. Does the agreement reflect the laws of the jurisdiction in which it will be enforced?
- Does the agreement cover issues that have no bearing on your contemplated business relationship? In other words, is the agreement over-inclusive?
- Is everything that should be in the agreement, actually in the agreement?

Once you have answered those basic questions, you will be better able to decide whether you should consult a professional.

Many companies have established “form” agreements that were tailored to their exact requirements and are used in routine transactions that are very similar and repetitive. The effort that was put into generating such “form” agreements (executives and professionals collaborate to create a company specific form) is the key difference between such “form” agreements and agreements purchased on the internet. These “forms” are constantly updated to reflect changes in the law.

### What is the basic law that supports my planned business relationship with Joe?

Agency law forms the basic foundation of sales representative agreements. Agency law governs the relationship between a principal (in this case you) and the principal’s agent (in this case Joe). To a certain degree, employment/labor law also has some impact on the sales representative agreements, particularly when the principal attempts to exert too much control over the agent.

Agency law is premised on the existence of a relationship of trust and confidence, a *fiduciary* relationship, between the principal and the agent. Once an agency relationship exists, there are certain implicit duties, rights and responsibilities that principal and agent should be aware of.

In the context of your agreement, Joe, as your agent, will owe you five duties:

1. Performance: duty to use reasonable diligence and skill in performing his agreed tasks.
2. Loyalty: duty to act for the benefit of you the principal and not himself or a third party.
3. Obedience: when acting on your behalf, Joe will be obligated to follow all of your instructions so long as they are clearly stated and comply with the law.
4. Notification: if Joe knows of a matter that concerns your agency relationship, he is legally obligated to inform you of the matter.
5. Accounting: based on your agreement, Joe may have a duty to keep an account of sales, payments and disbursements and make that account available to you.



You, as the principal, will also owe Joe, your agent, some duties:

1. Compensation: you will be obligated to pay Joe in a timely manner for the services he provides.
2. Reimbursement: if Joe, while performing his duties, pays necessary expenses out of his own money, you will have to reimburse him.
3. Cooperation: you have a duty to not interfere with Joe’s ability to perform his duties. If you tell Joe he is your exclusive U.S. agent, you have a duty not to directly or indirectly compete with Joe.
4. Indemnification: if, in the course of lawfully carrying out his duties, Joe incurs liability, he can seek to recover from you. A third party could also seek to recover from you. The extent of indemnification should be directly addressed in your agreement with Joe.

Agency law plays an important role in any principal/sales representative relationship and your agreement should be reviewed with this in mind.

**My cousin Niraj thinks that I should have bought a distributor agreement instead of a sales representative agreement. What’s the difference? Is there any legal affect on my business relationship with Joe?**

Arvind, I’ve been speaking to you with the assumption that you were planning on making Joe your sales representative (also known as an *independent foreign agent* or *commission agent*). As your U.S. sales representative, Joe will sell your products but not take title and would receive commissions and possibly a salary. However, if you made Joe your independent U.S. distributor, Joe would purchase your company’s products and resell them through his distribution network. One of the most important legal differences between a sales representative and an independent distributor is that if Joe were your U.S. distributor, a principal-agent relationship would not exist. Your distributor agreement should clearly state this.

I’m going to fax you a table that indicates key legal differences between sales reps and distributors. (here’s what Arvind received)

	<b>Sales Representative</b>	<b>Independent Distributor</b>
1. Agency Relationship?	<b>Yes</b>	<b>No</b>
2. Power to bind principal to 3 <sup>rd</sup> party via contract?	<b>Maybe</b>	<b>No</b>
3. Paid by principal (commission and/or salary)?	<b>Yes</b>	<b>No</b>
4. Takes title to goods?	<b>No</b>	<b>Yes</b>
5. Bears risk if buyer does not pay?	<b>No</b>	<b>Yes</b>

**Joe wants me to change the agreement so that his sales company, Bleu Sales Co., is my sales representative. This seems like a minor point. The agreement is not set up that way and I think I should leave it the way it is. Does it matter whether Joe or his company is the sales rep?**

Depending on your plans and the jurisdiction that Joe operates in, this “minor point” could be a big deal. Generally, businesses like to specify that an entity and *not* an individual is their sales rep. The main reason for this is to protect against local labor laws. In some jurisdictions, even if you do a good job of drafting your sales



rep agreement to specify that the sales rep is an independent contractor, local labor laws may still apply. In some cases, those local laws will prohibit at-will termination and, when termination is allowed, require you to make significant termination payments. Also, labor laws tend to require regular contributions to fund employee social security, workers compensation, retirement, health benefits, etc.

To avoid inadvertently triggering a labor law, many companies will hire an entity as their sales representative and, by doing so, buffer themselves. Some companies also avoid paying salaries and only pay commissions.

This issue also affects distributor agreements. To prevent a court concluding that your distributor agreement in actuality masked an agency relationship or, worse yet, an employer-employee relationship, the appropriate distance between you, the principal, and your distributor must be maintained. Actions such as (i) allowing the distributor to take goods on consignment, (ii) allowing the distributor to use your company's name, trademarks or servicemarks, or (iii) providing the distributor with start-up capital, may leave the impression that your independent distributor is not so independent.

**Because Joe is located in the U.S. and I am based in India, I will not be able to manage Joe as I do my other sales employees. What can I do to contractually ensure Joe represents my company the way that I'd like him to?**

In your agreement, be sure to clearly state Joe's duties and responsibilities. Generally, sales rep and distributor agreements have sections that deal with the following broad topics:

- Territory
- Duration
- Seller's/Representative's Obligations
- Sales Efforts
- Required Reports
- Responsibilities of Representative/Distributor
- Advertising/Marketing

These topics, as well as others, are used to clearly define the rights and responsibilities of both parties. Some agreements are more detailed than others.

If your intent is to establish an independent sale representative relationship, you have to be careful. The exertion of too much control will change the agency relationship such that your independent agent will be viewed by local law as an employee-agent. Setting hours for Joe or making him adhere to a tight schedule is an example of exerting too much control.

Generally, distributor's have greater independence than sales reps. Because distributor's buy goods directly from the seller and by doing so obtain title to the goods, distributor's are free to set re-sale prices, can appoint sub-distributors or agents, and have free-rein to sell the goods within a set geographic allocation. Sales reps usually are restricted to finding a buyer and referring that buyer to the seller (in this case your company). Then, the seller sets the terms of the sale.



**Besides agency law which you mentioned earlier, are there any other laws that may impact my contractual relationship with Joe?**

Arvind, these are the big ones:

- Employment/labor law – it is important to be clear that your agreement establishes an independent contractor relationship and not an employee-agent relationship.
- Antitrust law/anti-competition law – we haven't touched on this one, but in certain jurisdictions, the European Union for one, antitrust or anti-competition law may impact your agreement, particularly if your agreement was for an exclusive distributorship.
- Tax law – while tax law will not directly affect your relationship, you may want to take it into consideration. Under U.S. tax law, sales that occur through an employee agent result in income being attributable to the company, but if those same sales occur through an independent agent the income will not necessarily be attributable to the company.

Of course, contract law will have a direct impact on your agreement. And, if something goes wrong, tort law may also have an affect.

**Laws change. I'm worried that a change in U.S. import or Indian export laws will change and affect the profitability of my agreement with Joe. How can I change my agreement so that I'm protected?**

The best thing to do is to specify in the agreement that, in the event a change in the law impacts your ability to meet your obligations under the agreement, you have the ability to terminate or postpone those obligations. U.S. companies that enter into sales rep or distributor agreements with non-U.S. individuals or entities generally insert into their agreements a clause regarding the U.S. export laws. These clauses go as far as requiring overseas distributors to refuse to re-export goods to certain countries that U.S. export laws prohibit U.S. exporters to export to.

Similarly, if your country has any laws that potentially hold you responsible for acts that your U.S. sales representative or distributor may commit, be sure to revise your agreement so that it clearly states that your sales rep or distributor agrees to not commit those acts. As an example, in the U.S., we have the Foreign Corrupt Practices Act which holds a U.S. company directly responsible for certain acts of bribery, even if committed by their foreign sales rep or distributor. The penalties are huge (prison and tremendous fines) so companies that have good advisors insert protective language into their agreements.

**My contract manager has trouble reading contracts that are written in English and therefore I like to have all my contracts translated into Hindi and presented in two languages. If I have to go to court, will this cause a problem?**

Contracts that are presented in two languages can cause huge headaches down the road. The first question is which version of the contract controls a dispute. If the translation says one thing and the original says something



different, but it is not clear which is the controlling version, the court is free to pick whichever version that it wants to. Why leave it up to the court?

Best practice is to make sure that the contract is only executed in one language. The contract should state that translations of the agreement have no legal effect. In this case, if a party wants an unofficial translation of the agreement, there is no problem.

Alternatively, if it is absolutely essential that the executed contract be in two languages, be sure to specify that one of the languages is the official language and that, in the event there is a conflict, the official language version is the only version that matters.

**Joe has asked me to change the agreement so that it says that his commission payments will be split between two accounts, one in the U.S., and one in Seychelles. What's the best way for me to write this into the agreement?**

This situation needs to be handled with care. In some cases, if a sales representative requests that payments be made to different accounts in different countries, the sales representative is attempting to avoid local laws or regulations. The intent may be to avoid tax laws or currency. Some jurisdictions place limits on the amount of commissions a sales representative may earn. Whatever the case, be sure that you are not violating local laws and putting your ability to do business in the country or jurisdiction at risk.

Of course, Joe may have no intention of causing harm or violating laws. In this case, after a careful analysis of potential legal liability, have an attorney draft language that honors Joe's request, and protects you from potential fines and criminal court.

**The contract currently says that all disputes are to be litigated in Alaska and that Alaskan law will apply. Joe says that he loves Alaska, but I'm not sure that I'm comfortable with this since I am based in India. What should I do?**

Unless Joe lives and does business solely in Alaska and Alaskan law mandates that all disputes be litigated in Alaskan courts using Alaskan law, you should negotiate for another venue and choice of law. If Alaska does mandate Alaskan law and Alaskan courts, then no matter what venue and law you choose, if something goes wrong and you end up in court in Alaska, the court will ignore your choice of law and venue. Research done at the outset generally makes this a non-issue.

Parties that can agree on a venue and choice of law will sometimes choose a neutral venue – a venue that is pleasing to all parties because it does not give either party an advantage. An increasingly more common solution is to require that all disputes be subject to mandatory arbitration. To avoid bias to the advantage of either party, arbitration in a neutral venue may be proposed.

In the U.S., at both the Federal and the State level, arbitration agreements are rigorously enforced. At the Federal level, the Federal Arbitration Act (FAA) applies to all agreements that affect inter-state and international commerce. Although arbitration can be a good dispute resolution solution, particularly with regard to choice of law and choice of venue, there are downsides. The cost of arbitrating a case may not be any less



than litigating a dispute, particularly where the arbitration clause calls for three arbitrators. When you agree to arbitrate, you agree to give up rights such as the right to trial by jury, and the right to discovery. Under the FAA, a judge can only reach a conclusion about whether you entered into an arbitration agreement and whether your dispute falls under the scope of the agreement.

If you lose in arbitration and attempt to go to court as a remedy, the judge can only vacate the award if there was egregious behavior on the part of the arbitrator. Corruption, fraud, undue means and “evident impartiality” constitute egregious behavior. As you can imagine, it is tough to get an arbitration award vacated.

**My cousin Niraj thinks that I should make the contract good for 1 year. Joe wants a 10 year contract. The contract currently says that it is good until termination. I’m confused. What should I do?**

To a large extent, this is a business issue. However, the law may have some impact on your decision. As written, your contract is legally an indefinite agreement that may be very difficult to terminate. In some jurisdictions, you would be required to compensate Joe if you terminated what appeared to be an indefinite agreement.

To avoid this problem many parties that wish to enter into long-term business relationships, use so-called “evergreen provisions” that basically say that the contract is good for one year and will automatically renew for additional one-year terms unless either party terminates with notice (usually 60 or 90 days). This type of provision is, to a lesser degree, also open to being interpreted as indicating an indefinite term and therefore requiring the terminating party to compensate the non-terminating party.

Another solution is to specify a short, non-renewable term, say one or two years, and 30-60 days prior to expiration of the original agreement enter into a new agreement that is essentially identical to the original agreement.

**You have been very helpful and I may have you review my agreement or draft me a new one. What is your procedure for reviewing an agreement? What about drafting an agreement? What are your fees?**

Whether reviewing an agreement that you provide or drafting an agreement that, from the outset, adheres to your requirements, I follow the same process.

- I communicate with you to get an excellent sense of your business goals and your sense of where the risks are. Your goals and concerns form the foundation of the agreement.
- Next, I make a list of potential legal issues and perform research to get a good grasp of the legal landscape.
- After completing the above, I perform an initial review or draft a first-draft of your agreement.
- Either my comments or the first draft is distributed to you.
- You review either the revised agreement or the first draft and provide your comments or questions.
- I then revise and clarify the agreement as necessary so that the end result fits your situation and provides you with maximum legal protection.



**AbdulJaami, PLLC**

**International Commercial Transactions**

- As much as possible, I avoid charging by the hour.
- A review of a common agreement, such as your sales representative agreement, starts at \$500.

### About the Author

Saboor H. AbdulJaami is a graduate of Cornell University where he majored in Biology and concentrated his studies in the field of Genetics and Human Development. An attorney and counselor at law admitted to and in good standing with the Bar of the State of New York, Mr. AbdulJaami earned his Juris Doctorate from New York University School of Law, a law school that consistently ranks in the top five of all United States of America law schools. After graduating law school, Mr. AbdulJaami was employed as an associate in the Corporate Finance department of Kaye Scholer LLP, a 400+ attorney full-service New York City law firm, where he focused his practice in Securities, Mergers & Acquisitions, Finance, Structured Finance and Private Equity. While at Kaye Scholer LLP, Mr. AbdulJaami participated in over US\$2 billion of corporate and commercial transactions. In February of 2005, Mr. AbdulJaami left Kaye Scholer LLP and formed his own law firm and advisory company, AbdulJaami, PLLC.

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