

Tapping the Brazilian Market: Sales Agent or Distributor?

Introduction

A variety of business structures are available for gaining access to international markets, including sales made via foreign distributors, sales agents or a direct sales force. Many factors come into play in determining which structure is the most appropriate, such as legal and tax issues, the business and cultural environment of the target market and the US company's degree of familiarity with that environment. Selecting the proper structure requires balancing considerations of cost, control, risk and reward. In general, business structures that provide significant control over foreign operations require a significant commitment of resources and involve more risk. For example, sales made through a locally appointed sales agent lend a degree of control over the foreign sales process but require compliance with various foreign legal, tax and other requirements in order to avoid inadvertently creating an employment relationship and triggering other liabilities. By contrast, structures that involve a lower level of commitment usually provide less control for the US company and, perhaps, less potential for profit. If foreign sales are made through a distributor, little additional investment may be necessary but the US seller may retain little or no control over the ultimate disposition of its products in the foreign market and the potential for profit on overseas sales will be shared with the distributor. This article highlights some of the issues that should be considered with respect to the appointment of a sales agent or a distributor in Brazil and highlights

some key issues that should be addressed in every foreign jurisdiction where the US company intends to do business.

Sales agent versus distributor

Although the terms are often used interchangeably, a sales agent is quite different from a foreign distributor or reseller. A sales agent is "an agent employed to sell goods or merchandise on behalf of the principal."¹ A distributor or reseller, on the other hand, purchases the goods from the manufacturer/developer and takes the economic risk in those goods before reselling them at a higher price to the ultimate customer. The distributor's compensation is typically the difference between the price it pays for the goods and the price for which it sells them.

Under Brazil's agency law, a sales agent is either an individual resident in Brazil or a corporation established in Brazil and duly registered with the Regional Board of Sales Agents. The principal is a manufacturer, importer or distributor of products, whether or not established in Brazil. The sales agent, working on behalf of the principal, finds and arranges sales transactions, prospects clients, receives proposals or purchase orders on a regular basis and passes them to the principal, who then sells its products directly to the customers based on the purchase orders solicited by the agent.

Engaging an individual as an agent, rather than a company, creates the risk of accidentally triggering an employment relationship with the agent if all the following

conditions are met: (i) the services or duties are always provided by the same person; (ii) payments are made on a regular and consistent manner; (iii) the services are provided on a regular and continuing basis; and, most importantly, (iv) the agent does not have the freedom to act or determine his/her business transactions, but rather follows strict orders and procedures dictated by the principal.

Given the potential risks associated with a sales agency relationship, the US company might want to consider a resale or distribution arrangement in Brazil, under

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KEY ATTORNEY CONTACTS

Nadine Teixeira 650/843-5522
n Teixeir@cooley.com

Julie Wicklund 650/843-5093
jwicklund@cooley.com

Michael Marinelli 202/842-7830
mmarinelli@cooley.com

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which the distributor buys and resells the principal's products at its own risk. In principle, there is no specific law governing distribution agreements in Brazil; they are ruled by the general principles of civil law. However, the Brazilian Civil Code does provide that certain of a sales agent's rights may also apply to "distributors." This issue has not yet been tested by the Brazilian courts so there remains some uncertainty in this area. It is always important to have a proposed agency or distribution agreement reviewed by local counsel in Brazil, to ensure the US company's rights and liabilities are clearly and accurately spelled out in the agreement.

Products covered by the agreement

Any agency or distribution agreement should identify as precisely as possible the products or services covered by the agreement. If additional products or services are added later, these should likewise be identified in writing. Also, bear in mind that Brazil's agency law prohibits any changes in the agency agreement that result in a reduction in the average earnings of the sales agent calculated over the previous six months. As a practical matter, this prohibition may restrict the principal's ability to change the mix of products or services offered through the agent. Such a limitation does not apply to distribution agreements, giving the US company more flexibility to add or substitute products and services.

Compensation

A sales agent is entitled to a commission based on a percentage of the "total value" of the products sold to customers. Although Brazilian law does not define "total value," the courts have concluded that the "total value" is the invoiced price of the product, less taxes. In any event, it is highly recommended that the parties define the term "total value" in the sales agency agreement. The principal has sole discretion to set the prices of the products and an agent in

Brazil is generally entitled to receive commission on sales when the orders are paid for. Commissions must be paid to the agent no later than the 15th day of the month following the payment of the invoice by the customer.

The distributor's compensation is the surplus on the resale price of the goods. Prices of the goods to the distributor are established by the principal. However, prices of the goods to the customer are exclusively established by the distributor. Under Brazilian law, the principal cannot control the resale price of goods sold by the distributor or otherwise influence the final price to the customer.

Exclusivity

An agency relationship may be either on an *exclusive* or *non exclusive* basis. If the agreement is silent on the point, the agent cannot perform the same service for the principal's competitors.

The agreement must establish the territory to be covered by the sales agent. This can be defined as a geographic area or as a certain group of customers. Brazil's agency law provides that if the agreement sets forth an exclusive territory or is silent on the point, the sales agent may be entitled to a commission on any direct sales by the US company into the territory.

A distribution agreement must also establish the distributor's territory. The appointment of the distributor can be either on an exclusive or nonexclusive basis. In case of an exclusive territory, the distributor may claim indemnification from the US company based upon the losses and damages it actually suffers if the US company breaches the exclusivity arrangements and makes direct sales to customers in the distributor's territory. Again, it is important to have the agreement reviewed by local counsel in Brazil to protect the US company's rights.

Acceptance and rejection of purchase orders

Brazil's agency law also sets certain criteria for the valid acceptance or rejection of purchase orders by the principal. The sales agent must send a firm purchase order from a customer to the principal, which the latter may accept or reject. The US company (principal) must reject the purchase order in writing if it does not want to complete the sale within the time frame agreed by the parties in the agency agreement, otherwise the sales agent may be entitled to a commission as if the order had been fully accepted by the principal. The sales agent may also be entitled to indemnification if the principal persistently rejects purchase orders submitted by the agent and makes the relationship impracticable for the agent.

In a distribution relationship, however, the parties may freely agree upon the procedures for acceptance or rejection of purchase orders, as the criteria set forth in Brazil's agency law will not apply.

Product liability

A sales agent is not liable to customers for a principal's products, unless the agent provides technical assistance or implementation/maintenance services in addition to its sales agency duties. Therefore, a principal cannot require a sales agent to carry product liability insurance under the sales agency agreement.

Under Brazil's consumer protection laws, a distributor or importer is jointly liable with the principal to customers in Brazil for the product. The principal may therefore require its distributor to carry product liability insurance with respect to goods sold in the territory.

Term

If a fixed term sales agency agreement is renewed, expressly or by implication, it is treated as an agreement for an indefinite

term under Brazilian law (an agreement can be renewed by implication if the US company continues to accept orders after the agreement expires). Likewise, any agreement that succeeds another agreement within six months, whether or not the original agreement ran its full term, will be considered an indefinite-term agreement.

The parties are free to agree to the term of a distribution agreement under Brazilian law.

Ending the relationship

A principal may terminate a sales agency agreement for cause, without payment of any indemnification to a sales agent, in the event (i) the sales agent is negligent in complying with its obligations under the agreement; (ii) the sales agent's actions discredit the principal; (iii) the sales agent fails to comply with any obligations inherent in the sales agency relationship; (iv) the sales agent is found guilty of any crime which adversely affects the reputation of the principal; or (v) the principal and agent mutually agree. The sales agent may terminate the agreement for cause in the event of: (i) a reduction in the sales agent's activities in breach of the agreement; (ii) a direct or indirect breach of the agent's exclusivity; (iii) abusive price fixing for the sales agent's territory, with the exclusive purpose of jeopardizing the sales agent's normal activities; (iv) the principal's failure to pay commissions in a timely manner; or (v) force majeure. Termination of a sales agency agreement for cause by the sales agent, or without cause by the principal, entitles the sales agent to the following compensatory payments:

- (x) A minimum indemnification payment, which may vary depending on whether the agreement is for a fixed term or an indefinite term;
- (y) Commissions in relation to orders received or executed by the principal, with payment due on the termination date; and

(z) Compensation for all useful services rendered to the principal.

Despite the rules outlined above, a principal may only terminate a sales agency agreement without cause after the agent has recouped its own investment in the agency relationship (such as marketing or advertising costs), which can severely limit the ability of the US company to change agents in Brazil.

The parties are free to agree to specific termination events under a distribution agreement. For instance, the agreement may be terminated without cause upon prior written notice without further penalties or indemnification. In the case of early termination of a fixed term agreement by the principal, a reasonable prior notice should be given to the distributor. However, the distributor may still claim indemnification for early termination of the agreement if the distributor can show it has suffered actual loss or damages due to the termination.

Governing law and jurisdiction

Brazil's agency law states that any disputes arising between the sales agent and the principal will be submitted to a Brazilian court in the state where the sales agent resides, even if the agreement purports to have the law of a US state or other foreign jurisdiction govern the contract and provides that disputes are submitted to a US court or other jurisdiction. Similarly, Brazilian courts will have jurisdiction over distribution agreements and may disregard the jurisdiction or venue chosen by the parties in the distribution agreement.

Conclusion

Key issues affecting sales agency and distribution relationships overseas are very country-specific. A structure or arrangement that works in one country may be inappropriate in another. The discussion in this article is not an exhaustive review of all legal aspects involved in a sales agency or distribution relationship in Brazil. As such,

we recommend that US companies fully consider the potential benefits and shortcomings of all available business structures for doing business internationally before proceeding. To discuss suitable distribution arrangements and answer any other questions about sales agency and distribution relationships overseas, please contact a member of the International Business practice at Cooley.

We would also like to thank Pinheiro Neto Advogados (www.pinheironeto.com.br), Brazil, for their invaluable contributions to this article. ■

Notes

- ¹ Definition of "mercantile agent" in Black's Law Dictionary—Eighth Edition (ISBN 0-314-15199-0)