

## **Agent Or Distributor? US Suppliers' European Dilemma**

A number of clients of Faegre Baker Daniels LLP's U.S. offices have indicated that they were considering expanding their businesses into Europe but didn't wish to take the risk of starting up their own permanent establishment or incur the expense of acquiring a bolt-on business within Europe.

### **So What Are the Alternatives?**

Distribution arrangements or, alternatively, agency arrangements are often used as a low-risk means of expanding business into new territories. However, they are two different concepts and have very different legal consequences. Distribution and agency arrangements can catch out the unwary. The competition, or antitrust, laws impacting these commercial arrangements within Europe differ greatly from the U.S. position.

### **What Are the Differences Between Distributorship and Agency?**

A distributor purchases goods on his own behalf from the manufacturer or supplier and then sells the goods to his customers, generally having added a margin to cover his costs and provide a profit. The title in the goods in question will pass to the distributor, and then from the distributor to his customer on the resale.

An agency differs because an agent is appointed by the principal to negotiate and possibly conclude contracts with customers on the principal's behalf. At no point does title in the goods pass to the agent, and, generally, the agent has no contractual liability to the customer. The agent does not make a profit on the sales as such but generally gets rewarded through the payment of a commission, often calculated as a percentage of the sale price of the goods.

In a distributorship, the supplier of the goods has very limited ability to control the terms on which the distributor resells the goods. On the plus side, though, in selling products to a distributor, the supplier also passes on a large degree of the trading risk, which does not happen when using an agent.

### **Which Arrangement Should You Choose?**

The decision as to whether one should appoint a distributor or appoint an agent in large part depends on how much control a supplier wishes to have in relation to the terms on which goods are sold into the new territory.

There are EU competition rules, and, in many cases, also local competition rules, which prohibit anti-competitive agreements and abuse of a dominant position, and they may have impact on the appointment of a distributor. Such rules do not generally apply to a genuine agency relationship.

An agency relationship is genuine for competition rules if the agent bears no significant financial or commercial risk. It is immaterial whether the agent acts for one principal or numerous principals.

A supplier will usually be committing a breach of the competition rules if it sets the price or other terms on which the distributor must resell the products.

Provided that a distributorship agreement is drafted carefully, and the shares of the supplier and distributor are both below 30 percent of the relevant market, the arrangement can be drawn in such a way as to benefit from an automatic (block) exemption afforded to vertical agreements.[1]

An agreement falling outside the block exemption does not necessarily fall foul of the competition rules but must be assessed on an individual basis.

The block exemption sets out a number of "hardcore" vertical restraints, which, if included in a distribution agreement, will then mean that the whole agreement is prevented from having the benefit of the block exemption.

In addition, the EU Commission has indicated that such hardcore restraints will in general be viewed as restrictions of competition by "object." They will be presumed to infringe the competition rules regardless of their actual effect on competition, which will then require the parties to show that there are sufficient pro-competitive efficiencies to avoid a breach of the competition rules.

Those hardcore restrictions include:

- Price-fixing or resale price maintenance, direct or indirect, although a supplier may impose a maximum resale price or recommend a resale price.
- Territorial/customer sales restrictions. However, the following are permitted:
  - A restriction on the distributor's place of establishment;
  - A restriction on "active sales" into an exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another distributor.

There are certain other vertical restraints which, while not hardcore, would fall outside the scope of the block exemption. Severability does apply to these less offensive restraints, so that the inclusion of such a restraint would mean that the benefit of the block exemption would only be lost for the offending parts of the agreement.

These lesser outlawed restraints include:

- Any direct or indirect noncompete obligation that lasts indefinitely or exceeds five years; and
- Any direct or indirect noncompete obligation on the distributor relating to any period after the termination of the distribution agreement.

Competition rules should be taken very seriously, as any restriction in contravention is automatically void and unenforceable, and the parties can be subject to substantial fines of up to 10 percent of their worldwide turnover. In addition, a third party may claim damages against the supplier and distributor if he can show that he has suffered a loss as a result of the offending restraints operated between the supplier and distributor.

Therefore, if the supplier wishes to:

- Retain the freedom to fix the prices of his goods being sold into the new territory, and/or
- Restrict to whom the goods are sold in the new territory, an agency arrangement is going to be more appropriate than the appointment of a distributor.

### **Other Matters to be Considered**

In the EU, there are regulations which mean that in most cases where an agency arrangement is terminated, the agent is entitled to some sort of compensation payment. There are no equivalent EU regulations relating to the termination of a distributorship arrangement, and, generally speaking, there is no requirement to make such a compensation payment to a distributor. That is certainly the case in the UK; however, in some other EU countries — for example, Germany — there are local laws which may require such a compensation payment on termination of a distributorship arrangement.

### **Commissionaires**

While the concept does not exist in the UK, commissionaires can be found elsewhere in the EU, particularly France, Italy, the Netherlands, Spain and Germany.

In such arrangements, no relationship is created between the principal and the customer, so the customer cannot make a claim against the principal, nor can the principal sue the customer for the price.

The principal is contractually bound to the commissionaire to deliver, through the commissionaire, the goods sold to the customer, and the commissionaire is contractually bound to the principal to remit the price received from the customer.

The commissionaire is remunerated by way of commission paid by the principal.

The competition rules would apply to a commissionaire relationship, but for tax purposes, such an arrangement is at low risk of being seen as a permanent establishment in a country by the principal.

### **Conclusion**

There are certain advantages and disadvantages in using either an agent or a distributor. The supplier needs to think carefully about what he wants to achieve in the new territory and how much control he wishes to retain before making a decision as to which route to follow. Making the wrong decision could be very costly.

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[1] A vertical agreement is an agreement which is entered into between businesses operating at different levels of the economic supply chain—for example, franchising arrangements as well as distribution agreements.

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