Local distributors are an excellent resource to help companies penetrate global markets. But the distribution of products in non-U.S. jurisdictions presents legal challenges that business owners need to consider when structuring distributor relationships.

"Local laws will differ in each jurisdiction, although the European Union has adopted various directives intended to create a consistent body of distribution laws and regulations for the member countries," said Mary Wasik, partner, Corporate Practice Group, Levenfeld Pearlstein, LLC in Chicago.

"Obtaining competent and responsive local counsel is recommended to provide the necessary guidance."

Smart Business asked Wasik why noncompetition restrictions may not be permissible overseas, how to best protect intellectual property and what to consider when terminating a foreign distributing relationship.

How should a foreign distribution network
be structured?

Your decision to distribute products through third-party distributors or through sales agents will depend upon the nature of your product and the market in which it is distributed. The laws and regulations of the applicable jurisdiction may provide your distributor with certain rights and benefits and impose obligations on you, which vary with the legal structure of your relationship.

Can you restrict a distributor from selling competing products?

In the U.S., you may restrict a distributor from selling competing products during the period of your relationship and for some time after the relationship ends. The European Union has, however, adopted strict regulations regarding restrictions on competition. Non-competition restrictions are not permissible when they reduce the availability of competitive goods in the relevant markets where the goods are sold or purchased. If restrictions are permitted, you can prohibit a distributor from distributing competitive goods during the term of your relationship, and then only up to five years.

Restrictions after termination are only permitted for up to one year, if necessary to protect your substantial and indispensable
techniques and know-how. It is not an infringement of EU regulations if you require that nonpublic proprietary information be kept confidential. The decision to impose a restrictive covenant and the likelihood of enforceability should be addressed with local counsel, particularly if there is a risk that information, techniques and know how given to a distributor might be shared with a competitor.

What should be considered before a distribution relationship is terminated?

The laws of foreign jurisdictions will sometimes impose legal requirements on the manner in which your distribution relationship can be terminated. The distributor may also be entitled to monetary entitlements. For example, under the EU agency regulations, the activities of the agent may be considered to have contributed to your good will and, therefore, unless appropriately addressed in your distributor agreement, the agent could arguably be entitled to compensation for the loss of future commissions. Further, under certain circumstances, EU agency regulations might require a minimum of three months notice of termination. If you and your distributor continue to perform under an expired agreement, a question could arise as to whether you or the distributor intended the agreement to continue for an indefinite term.
In Middle Eastern jurisdictions, local recordation requirements could cause the distributor to obtain affirmative distribution rights, which could interfere with your ability to subsequently appoint other distributors.

What steps should be taken to protect intellectual property?

Filings for local trademark and patent protections are obvious first steps in preserving your intellectual property in foreign jurisdictions. Provisions in contracts that affirm your interest in IP are also necessary, but sometimes a distributor will also want to use the name of the product or manufacturing company in its business name. If this is acceptable, address this issue by the grant of a license to the distributor to use the name and require that such use ceases if your relationship ends. Police the use of your trademarks in all potentially applicable classes. If trademark registrations have not been made, sometimes the distributor will make filings in its own name. Further, such filings could be in different trademark classes that could be of value at some point in the future.

What law should govern the agreement between a product owner and distributor?

Any well-established body of law can be
selected to govern your distributor relationship, but of primary importance is the question of whether a judgment issued by a court in the governing jurisdiction will be recognized and enforced by a court in the jurisdiction where the distributor is located. Some jurisdictions, particularly in the Middle East and Asia, will more readily enforce an arbitration ruling by an international arbitration body, so disputes may be best resolved through arbitration.