DISTRIBUTION AGREEMENTS IN LATIN AMERICA: WHAT YOUR BUSINESS MUST KNOW BEFORE IT CAN DO BUSINESS.

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With 600 million people, an ever expanding middle class, and a growing economy already worth trillions[1], it is no wonder businesses in the United States are making expansion into Latin American markets a top priority. Such expansion, however, is not without risk. Chief among the risks is the cost of wading through complex foreign regulatory schemes governing commercial relationships or, even worse, operating in a region with ill-defined and malleable commercial laws. Businesses entering into the Latin American market would therefore be wise to first gain an understanding of the key regulatory constraints they will be facing. The following article seeks to assist businesses in attaining this understanding with regard to one of the most important instruments in a business" expansion tool-kit – the distribution agreement. Specifically, the article provides a survey of the key regulations affecting distribution agreements in the following eight countries: Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, Nicaragua, and Panama.

ARGENTINA

Argentina has no particular regulatory scheme governing distribution agreements but rather relies on a still developing body of case law affecting the terms of these agreements.[2] Under the case law, exclusivity provisions are valid and enforceable but will be voided if a court determines they are "abusive." With regard to termination, if the agreement's term is indefinite, a business may terminate it at any time with reasonable prior notice. If a business terminates the agreement abruptly and without adequate notice, however, it will face liability for consequential damages. Finally, businesses should take note that choice of law provisions in distribution agreements with local Argentinian distributors are likely to be ignored and Argentinian law applied regardless.

BRAZIL

Brazil began regulating distribution agreements in 2003 and the law governs and affects several aspects of the foreign company, local distributor relationship.[3] As to exclusivity, businesses should be aware that it is allowed. If the distributor is granted exclusivity, however, and the foreign company allows third-parties to carry out transactions anyway, the local distributor is entitled to remuneration. With regard to termination, a business may terminate the distribution agreement on 90-day notice to the local distributor.[4] Finally, with regard to indemnification, if the agreement is terminated without cause the local distributor is entitled to compensation equal to the amount owed to it pursuant to the agreement – including for pending transactions – at the time of termination.

CHILE

Chile does not treat distribution agreements as a distinct form of contract. Rather, distribution agreements in Chile are treated like any other type of contract and subject to the same general principles applicable to all agreements in Chile. This lack of specific regulatory oversight does not mean, however, that businesses have nothing to be aware of when it comes to entering into distribution agreements with Chilean distributors. Specifically, with regard to the termination of distribution agreements, business should be aware that where parties have agreed to a fixed duration, the agreement may only be terminated earlier for cause. Where the agreement is indefinite, by contrast, Chilean law allows either party to unilaterally terminate the agreement upon written notice to the other side and after the expiration of a reasonable period.

COLOMBIA

Colombia's laws are relatively unique in the region in that they tend to favor the foreign company.[5] Businesses entering into distribution agreements with local Colombian distributors are welcome to include exclusivity clauses in their agreements and may terminate after providing reasonable notice. Moreover, local distributors are not entitled to indemnification or other payment after the agreement is terminated.

COSTA RICA

Distribution agreements in Costa Rica are governed by the Sales Representative Act[6] and businesses seeking to engage local distributors in this country would do well to familiarize themselves with its restrictive requirements. The act is characterized by its general protective nature toward local distributors, the restrictions it places on circumstances in which a foreign company may terminate the distribution relationship, and its compulsory application of Costa Rican law.

With regard to terminating distribution agreements, foreign companies are quite limited in their options. A distribution agreement with a local distributor may only be terminated for offenses against the foreign company, for negligence, for a violation of a trade secret or duty of loyalty, or under the terms of the agreement itself. Further, if the agreement is silent as to duration, 10 months advance notice is required to terminate.

Moreover, other than the limited circumstances enumerated above, if a foreign company terminates a distribution agreement early it will face stiff indemnification costs. These stiff costs include not only all damages associated with the termination but also the cost to repurchase any inventory left over with an extra 10% paid to the local distributor as a financial cost.

With regard to exclusivity, it is allowed in Costa Rica but businesses should be aware that if they agree to grant the distributor exclusivity, the appointment of another agent, representative, or distributor gives cause to the original local distributor to terminate the agreement early.

Finally, businesses are cautioned that Costa Rican law will govern the terms of the distribution agreement despite any other terms to the contrary.

MEXICO

While commonly used among merchants, distribution agreements are nevertheless not regulated under Mexican law. Rather, distribution agreements in Mexico are given the same lenient treatment of their terms as is provided to other commercial agreements. Specifically, Mexican commercial law allows merchants to freely enter into contracts with any terms or conditions, provided that the agreement does not violate public policy and has no illegal purpose, the agreement is not subject to a formality, and the agreement does not violate applicable regulatory requirements.[7] In light of this lenient policy, typical contract provisions for distribution agreements in Mexico include exclusivity clauses, price and other guidelines for selling the products, territory restrictions, delivery procedures, and non-compete and confidentiality provisions.

NICARAGUA

Numerous laws affecting distribution agreements apply in Nicaragua[8] and businesses seeking to expand into this market should take special note of several of them as they tend to be protectionist. As an example, distribution agreements in Nicaragua cannot be exclusive or they run afoul of Nicaragua's "Competition Promotion Law." Further, a manufacturer seeking to enter into a distribution agreement in Nicaragua cannot impose conditions, such as pricing, that a distributor must follow when providing goods or services. Furthermore, the sale of a good in Nicaragua cannot be conditioned on the acquisition, selling, or providing of goods or services produced, processed, or distributed by a third-party.

Of particular interest to businesses seeking to contract with Nicaraguan distributors is the uncertainty surrounding choice of law and venue clauses in Nicaragua. This uncertainty stems from the fact that prior Nicaraguan law established that contracts should be subject to national law regardless of whether the parties provide otherwise and that all disputes of rights of parties to the contract must be heard in Nicaraguan courts. The act imposing these requirements was repealed in 1998. The provisions relating to choice of law and venue, however, were left in place; but it was not made clear whether such provisions apply only to contracts entered into prior to 1998 or whether they also apply to all contracts entered into after that time.

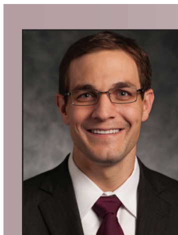
PANAMA

In 1989, the Panamanian Supreme Court declared the laws governing distribution agreements at that time to be unconstitutional and no similar act has been enacted since. In light of this, distribution agreements in Panama are generally subject to the terms and conditions agreed to by the parties. This lack of regulatory oversight makes Panama an attractive location for foreign businesses because it means that no mandatory indemnification or termination right exists for local distributors.

Exclusivity clauses, by contrast, are still prohibited under Panama's laws relating to restraint of trade as a vertical practice.[9] It should be noted, however, that under current Guidelines for the Analysis of Vertical Practices, an exclusivity clause in a distribution agreement may be valid as a temporary business development strategy. Any business seeking to engage a local distribution in Panama should thus explore this option more fully.

CONCLUSION

The opportunities and vibrant economic growth of Latin America make it an ideal target for business expansion. Businesses would do well, however, to gain an understanding of the regulatory and legal environments they are stepping into before entering the market. This is particularly true with regard to distribution agreements where a business may face substantial or little regulation depending on the country in which they are engaging a local distributor.



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1 Woodbridge International, *Latin America*, available at https://www.woodbridgegrp.com/global-ma/latin-america/ (last visited July 16, 2013); Frida Ghitis, *US Should Embrace Latin America*, CNN.com, available at: http://www.cnn.com/2011/12/08/opinion/ghitis-latin-america (last visited July 29, 2013).

2 Lex Mundi Guide to Doing Business, *Argentina*, available at http://www.lexmundi.com/lexmundi/Guides_To_Doing_Business.asp (last visited, July 29, 2013); Thomas F. Clasen and Joseph E. Puchner, *International Agency & Distribution Agreements* (Matthew Bender, Rev. Ed.) (2013).

3 Brazilian Civil Code Articles 717, 720 (2013).

4 A period of 90 days is not, however, always sufficient notice. Businesses must consider the nature and extent of the local distributor's investment in determining the proper amount of notice in their case.

5 Clasen and Puchner, *supra* note 2.

6 Sales Representative Act, Costa Rican Law No. 6209.

7 Mexican Commercial Code Art. 78, 79 (2013).

8 Tax Agreement Law, Law No. 822; Competition Promotion Law, Article 2 of Law No. 601.

9 Martindale Hubbel, *Panama Law Digest* available at http://www.martindale.com/members/Article_Atachment.aspx?od=1025846&id=369198&filename=asr-369200.pdf (last visited July 17, 2013).