

Key Insights into Agency and Distribution Agreements in Brazil: Avoiding Pitfalls

Investing in Brazil presents a wealth of opportunities for US investors, but understanding the legal landscape is essential for successful market navigation.

This article provides an overview of critical legal considerations focusing on agency and distribution agreements, as well as other key related factors. By understanding these aspects and preparing accordingly, US investors can better navigate the Brazilian market, ensuring compliant and successful business operations.

Agency Agreements

In Brazil, agency agreements are regulated by the Brazilian Civil Code (Law No. 10,406 of January 10, 2002) and the Commercial Representation Law (Law No. 4,886 of December 9, 1965). In these agreements, an agent promotes the sale of a product on behalf of a principal, acting as an intermediary between the principal and clients. The principal retains most of the business risks. It is crucial for principals to ensure that agents adhere to the company's branding and marketing standards to maintain a consistent market presence.

Agency agreements should clearly define the agent's commission structure, territory, duration, and conditions for termination. The ability of the parties to freely agree on the terms and conditions of agency agreements is somewhat limited by the Commercial Representation Law, which sets forth mandatory terms and conditions.

Key Points:

- Agents do not hold legal title to the products but may possess them for promotional purposes.
- Agents earn commissions for sales facilitated; agents will also be entitled to commissions on sales made by third parties in their territories.
- Termination of agency agreements without cause requires principals to indemnify agents.

Another critical consideration is the risk of agency agreements being recharacterized as employment agreements. This can occur if the agent's relationship with the principal resembles that of an employee, as defined by Brazilian law. For instance, this may happen when the agent receives a fixed compensation, is required to strictly follow the principal's instructions, or works exclusively for the principal. However, the key element in differentiating employees from agents is subordination, or the lack of freedom, autonomy, and independence in providing the service.

To mitigate this risk, agency agreements should be carefully drafted to clearly distinguish the roles and duties of an independent agent from those of an employee. Nonetheless, the determination of whether an arrangement is an employment agreement must be made based on the actual facts and circumstances. Therefore, the way agents are treated by principals is as important as the carefully drafted clauses. Ultimately, substance will always prevail over form.

Distribution Agreements

Distribution agreements are not specifically regulated by any particular law (except for distribution agreements for motor vehicles and their spare parts) but are governed by the general principles of the Brazilian Civil Code. These agreements are essentially sale and purchase agreements where a distributor buys products from a principal to resell them in a territory, either exclusively or non-exclusively, and at their own risk.

Distribution agreements should outline the responsibilities and rights of both the principal and distributor. It is crucial for the agreement to be detailed and clear to avoid potential conflicts. These agreements often include clauses on exclusivity, territory, pricing, payment terms, targets, and dispute resolution. Given that distributors act in their own name and for their own benefit, they carry the risk of unsold inventory and are responsible for marketing and after-sales services.

Key Points:

- Distribution agreements are governed by their own terms and conditions, allowing for free negotiation between parties.
- Distributors hold legal title to the products they resell, bearing all associated risks and rewards.
- Termination of distribution agreements without cause requires prior notice and may involve indemnification for investments made.

Other Legal Considerations

The early termination of both agency and distribution agreements needs careful consideration. The Brazilian Civil Code stipulates that termination without cause requires adequate prior notice and indemnification for specific investments made by the affected party. Principals must be mindful of the investments made (or required to be made) by their agents and distributors.

Additionally, the Commercial Representation Law ensures that agents are indemnified in an amount equivalent to 1/12th of their total compensation (fixed fees plus commissions) during the contractual period in case of early termination without cause.

Investors should note that fixed-term agency agreements can only be entered into once. When the initial term of a fixed-term agency agreement expires, the Commercial Representation Law considers any extension of such agreement and any new agreement that replaces it within 6 months as an agreement with an indefinite term, regardless of what the parties may agree or document. While the Brazilian Civil Code is not as clear about the extension or replacement of fixed-term distribution agreements, the same principle may apply (depending on the circumstances).

Other Key Points:

- Brazil operates under a civil law system, which means that reliance on case law and judicial precedents tend to be more limited.
- Investors should carefully consider the law applicable to their distribution agreements, ensuring that their choice aligns with the selected dispute resolution method. Agency agreements will be governed by the Commercial Representation Law.
- Brazilian courts may be the best choice for resolving certain disputes. Foreign decisions are subject to ratification by the Superior Court of Justice (STJ), making the enforcement process in Brazil more time-consuming and costly. Arbitration is a possible method for dispute resolution, but foreign arbitral awards are also subject to ratification by the STJ.
- English language agreements and other documents must be translated by a sworn translator in order to be enforceable in Brazil.
- In regulated industries (e.g., food and healthcare), specific cautionary measures may be needed, including ensuring that distributors handle product registration with the appropriate government agencies.

Taxation

Understanding taxation in Brazil is key. Import taxes and duties can significantly impact the cost structure of imported goods. Investors should seek advice from specialized tax professionals to understand the tax implications of their investment decisions. There is a tax reform currently underway in Brazil.

Key Points:

- Import taxes vary, and include II (0%-30%), IPI (0%-10%), PIS/COFINS-Imports (11.75%), ICMS (0%-25%), and AFRMM (0.25%).
- Technical and general services are subject to multiple taxes, such as IRRF (15%-25%), ISS (2%-5%), PIS/COFINS-Imports (9.25%), IOF/FX (0.38%), and CIDE/Royalties (10%).
- The absence of a treaty against double taxation between the US and Brazil creates additional challenges for US investors.
- Investors should avoid the characterization of a permanent establishment in Brazil, as this status can trigger significant tax obligations.

INCOTERMS

Using appropriate INCOTERMS (when applicable) can help avoid customs clearance issues and ensure clarity in the relationship with distributors and clients. For instance, DDP (Delivered Duty Paid) is problematic for foreign sellers as they cannot handle the customs clearance for goods entering Brazil. DPU (Delivered at Place Unloaded) or DAP (Delivered at Place) are more suitable alternatives.

Cultural Aspects

Successfully navigating Brazilian business culture is vital. Awareness of local negotiation nuances can significantly impact the outcome of business dealings. For example, in Brazil, “maybe” often means “no,” and “Ok” may not mean “agreed”, but “I hear you. I will think about it.”

Understanding and respecting Brazilian negotiation culture can facilitate stronger business relationships. Brazilians value personal connections and trust in business dealings. Meetings may start with casual conversations to build rapport before delving into formal negotiations. Patience and flexibility are key, as decision-making processes can be slower. By being aware of these cultural nuances, US investors can build successful and lasting partnerships in Brazil.

For more detailed information, investors are encouraged to consult legal experts specializing in Brazilian trade and investment.

This article is for informational purposes only and should not be relied upon to obtain legal advice on any of the topics dealt with here. For additional information, please contact the leaders of the Corporate and Foreign Investments team.

CGM Advogados. All rights reserved.

www.cgmlaw.com.br