

# Key Considerations: Appointing a Distributor in the UAE

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As we have highlighted in past editions of Law Update, a popular method of doing business in the UAE is through distribution arrangements entered into with local, appropriately licensed, distributors. These types of arrangements can give a principal immediate access to valuable local knowledge and resources, allowing a principal to establish its products in this region relatively quickly.

Our Commercial Advisory group are often asked to review a principal's standard form distribution agreement and we in this article we will highlight some of the key issues that should be considered in the context of such agreements under UAE law.

## **Commercial Agency Law**

A foreign based principal should always consider the potential application of local laws to an agreement. The UAE, and the wider GCC for that matter, have specific commercial agency laws which can afford local distributors significant legal protections. In respect of the UAE, Federal Law No. 18 of 1981 on commercial agencies, as amended by Federal Law No. 14 of 1988, Federal Law No. 13 of 2006 and Federal Law No. 2 of 2010 ("Agency Law") has application in the event that a local distributor is a UAE national or a company wholly owned by UAE nationals and the local distributor was appointed on an exclusive basis (in respect of one or more of the Emirates). The impact of this certainly needs to be considered by a principal and these issues have been addressed in detail in previous articles.

## **Taxes and duties**

In respect of the UAE, the products subject to a distribution agreement will generally be coming from overseas, so the parties should make it clear who is responsible for the associated import and export costs. A short form way to address this is by reference to a specific incoterm, which are a set of globally recognised standard terms that prescribe the respective responsibilities of a supplier and buyer, with regard to the delivery, importation and insurance obligations and so on.

Thought must also be given to the impact of any local taxes. Most standard form distribution agreements, especially those from principals which are subject to a tax regime in their home country, will already have provisions dealing with tax and the effect on any payments due under the agreement. Obviously, a principal needs to ensure that the price they expect to receive from the local distributor for the products supplied is not adversely effected by tax (i.e. by the local distributor deducting any tax payable and remitting the product price net of any applicable taxes). In the context of the UAE, whilst there is currently no withholding tax, which is implemented by some other GGC countries, it has been announced that VAT will be introduced on 1 January 2018. Therefore, a foreign based principal needs to ensure there are appropriate provisions dealing with the impact of VAT in the UAE.

## **Governing law and dispute resolution**

Often a foreign based principal will be comfortable with, and will want to ensure that, the governing law of its home country is that which governs their relationship with a local distributor. However,

generally speaking, the position in the UAE is that parties cannot agree on foreign courts to have jurisdiction if the UAE courts have original jurisdiction (e.g. in cases where the agreement is entered into or partially performed in UAE). This would be the case in respect of a distribution arrangement relating to the UAE. Further, where the UAE courts do assert jurisdiction and hear a dispute they will be likely to apply UAE law to that dispute even where a foreign governing law is provided for in the agreement itself. However, one method to try to ensure that the choice of a foreign governing law is recognised, is for the distribution agreement to refer to arbitration as the sole method of dispute resolution and not foreign courts. The UAE has formally acceded to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and under the terms of this convention, broadly speaking, the local UAE courts should refuse to hear any dispute where the parties have agreed to arbitration as the sole means of dispute resolution. An arbitrator will then recognise the choice of a foreign governing law to govern disputes in the agreement. Of course, this will not work with arrangements registered under the Agency Law as, pursuant to that law, the Commercial Agencies Committee and, on appeal, the UAE Courts will automatically have jurisdiction to hear disputes.

## **Termination**

Obviously, parties at the outset of a business relationship are keen to collaborate and anticipate a profitable working relationship. Of course, things do not always go as expected and it is important for a principal to be aware of issues that may arise in the context of termination of an arrangement. Under UAE law, being a civil law jurisdiction, if an agreement is valid and binding, parties cannot resile from it, nor vary or rescind it, unless by mutual consent, an order of the court, or by operation of law. Consequently, a foreign principal wishing to terminate a local distributor may find that, in the absence of the local distributor's agreement to terminate, it needs to approach the court for a court order that the termination is effective. This is particularly relevant where the principal may need to prove to local authorities that the termination is valid. Practically speaking, not every agreement is subject to the termination by court order but there is a risk that if reliance is placed solely on a contractual right to terminate and no court order is obtained then a local distributor could, potentially, try and raise an argument that a contract still exists between it and the foreign based principal. While a court will not force a principal and agent to carry on their relationship in the absence of an agreement between the parties to do so, the distributor may refuse to implement any consequences of the termination unless and until ordered by a court to do so.

Again, if the agreement is registered under the Agency Law then there are a number of separate issues to be considered in the context of termination of that arrangement and these have been discussed in detail in previous articles.

In the context of unregistered agreements, the inclusion of a specific reference to a foreign principal's right to terminate being able to be exercised "without the need for a court order or further notice" may be helpful in allowing that party to argue that any reliance on the relevant termination provision without seeking a court order or providing any further notice (other than any notice that may be provided for in the agreement itself) was specifically contemplated by the parties at the outset and should be upheld. Of course, the distributor may still choose to resist termination and not comply with any consequences of termination which would leave the principal with no choice but to pursue a court case or arbitration, as the case may be.

## **Potential right to compensation**

In the event that UAE law applies to a distribution agreement, there are concepts of "bad faith" and "abuse of rights" that may be relied upon by a local distributor to argue that it is entitled to claim compensation in the event of termination or non-renewal of their distribution agreement, even if such termination right is exercised, or expiry occurs, in accordance with the terms of the agreement itself. This is one of the main reasons why a foreign based principal will often seek to exclude UAE

law from governing the terms of their distribution agreement. The circumstances giving rise to the termination or non-renewal would need to be considered on a case by case basis when assessing whether any compensation may be payable to a distributor. Further, whether the arrangement was exclusive or non-exclusive would impact the assessment as to the amount of any compensation that may be payable. While the inclusion of a waiver by the distributor of any right to seek compensation may assist a principal in resisting any claims for compensation by a local distributor it will not, as mentioned above, necessarily guarantee this.

In the event that a distribution agreement is registered then the Agency Law applies and, as mentioned above, the Commercial Agency Committee and, on appeal, the UAE courts, will hear any disputes regardless of any express choice of governing law or dispute resolution forum specified in the distribution agreement.

## **Execution**

In the context of trying to ensure that a foreign governing law is upheld by the inclusion of an arbitration clause, a foreign based principal should ensure that the individual signing on behalf of the distributor is specifically authorised to bind that entity to arbitration. If a signatory is not appropriately authorised, then there is a chance that any arbitration clause would be considered void and, as a result, the UAE court would assert jurisdiction and apply UAE law. Usually, the authority of the distributor's signatory is evidenced in the Memorandum of Association or a separate POA, though there is a general assumption that a general manager of a local UAE based entity has the implied authority to bind an entity to arbitration. Notwithstanding this, we recommend that a principal obtain a copy of any relevant document that expressly confirms the signatory's authority.

Save for in respect of an agreement registered pursuant to the Agency Law, there is no need for a distribution agreement to be notarised or be in Arabic.

## **Structuring issues**

In order for any person or entity to undertake distribution activities in the UAE they must be appropriately licensed to do so by the relevant governmental authority. For example, in respect of Dubai, a locally based distributor would only be able to distribute products onshore (i.e. mainland Dubai) if licensed to do so by the Dubai Economic Department. If the intended distributor was a UAE free zone company then it would, in respect of the UAE, only be able to distribute the products within its relevant free zone and not onshore (and would need to appoint an appropriately licensed onshore distributor).

Similarly, in the event a foreign based principal is appointing a UAE based distributor in respect of a wider territory, say the GCC, then these countries' licensing requirements must be considered. In general terms foreign entities cannot directly undertake economic activities in these countries but need to appoint appropriately licensed third parties or establish appropriately licensed entities itself to undertake such activities.

As a result, provisions relating to assignment and the appointment of sub-distributors must be carefully considered in distribution agreements, even where a local distributor intends to use affiliates as its distribution network throughout a region. It is recommended that the master distribution agreement specifically make the granting of any assignment or sub-distribution rights conditional upon receiving the principal's written consent (in order for a principal to maintain an element of control and have transparency of arrangements concerning the distribution of their products).

We have highlighted some of the areas that a foreign based principal should consider when contemplating appointing a UAE based distributor. It goes without saying that it is vitally important for a principal to carefully identify the most suitable distributor and take into consideration the

various legal implications including those set out in this article.

*Al Tamimi & Company's Commercial Advisory team regularly advises on Distribution Agreements (for principals and distributors). For further information please contact Willem Steenkamp (w.steenkamp@tamimi.com or Robert Roberts (r.roberts@tamimi.com).*