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Understanding Key Agreements in International Trade & Commerce

Client Updates

International trade & Commerce transactions involve various contractual arrangements, each with distinct legal and commercial implications. Selecting the appropriate agreement is essential for defining the parties' rights and obligations, ensuring compliance with applicable laws, and mitigating risks.

This client update explores the three main types of agreements in international trade – **supply** agreements, **agency** agreements and **distribution** agreements. Each structure carries unique considerations that must be carefully addressed to avoid unintended liabilities, especially taking into account that the title of the agreement often belies its true nature and that the courts are expected to examine the substance of the agreement rather than its title when classifying the type of contract.

Overview of the main types of Agreements

- Supply Agreements: These contracts govern the sale of goods between a supplier and a purchaser. The supplier delivers goods to the buyer, who takes ownership and assumes risk upon delivery. These agreements often address pricing, delivery terms, quality standards, and liability provisions.
- Agency Agreements: In an agency arrangement, a supplier appoints an agent to promote or sell its goods on its behalf. The agent does not take ownership of the goods but facilitates transactions between the supplier and end customers. The supplier typically retains control over pricing and contractual terms, and the agent is usually compensated via commission.
- Distribution Agreements: Unlike an agency agreement, a distribution agreement involves the distributor purchasing goods from the supplier and reselling them in a defined territory. The distributor takes ownership of the goods, assumes risk, and often manages marketing, sales, and customer service.

Supply Agreements vs. Distribution Agreements

Both supply and distribution agreements involve a full buy-sell transaction, where the buyer assumes ownership of the goods and takes on the associated risks. However, key differences lie in the level of involvement of the seller after the transaction and the extent of control retained by the seller.

In a typical **supply agreement**, once the buyer purchases the goods, the seller is generally not involved in the buyer's subsequent activities. The buyer assumes full ownership and the risks related to the goods, and

the seller's obligations usually end with the delivery of the goods as per the agreed terms.

While a **distribution agreement** also involves a buy-sell transaction, the seller grants the buyer (the distributor) the right to sell and distribute the goods, typically within a defined territory and for a specified duration. This arrangement comes with a set of obligations that provide the original seller with some control over how the products are distributed and marketed. These obligations may include commitments from the distributor to invest in marketing and promotional activities to increase sales, training staff who sell the products, meeting minimum sales targets to maintain distribution rights, and other marketing and operational requirements that ensure the continued success and integrity of the product's distribution.

Distribution Agreements vs. Agency Agreements

A **distribution agreement** governs the relationship between a supplier or manufacturer and a distributor, who purchases goods and resells them to third parties independently, usually in a designated territory. The distributor under such structure assumes ownership of the products, and bears the risks associated with such sale.

An **agency agreement**, in contrast, involves a commercial agent who negotiates sales on behalf of the supplier. The agent is limited in shaping the sale conditions, does not take ownership of the goods, and accordingly the supplier is the one that retains the ownership, that sells the goods to the purchaser and that bears risks associated with the transaction.

Misclassifying a distributor as an agent (or vice versa) can have significant legal implications, particularly regarding liability, termination rights, and compliance with local agency laws that may grant agents special protections. As an example, the Israeli Agency Contract Law (Commercial Agent and Principal), 2012 provides that if the agreement is terminated by either party, the commercial agent may be entitled to compensation from the supplier for agreements with new clients or for a significant increase in the supplier's business volume with existing clients if the agent was the "effective factor". As another example, companies should also assess whether their agency agreement creates an unintended permanent establishment in the buyer's jurisdiction, which could have tax implications.

Key Issues to Consider in International Trade & Commerce Agreements

- **Ownership and Risk Transfer:** Agreements should clearly define when ownership and risk pass from seller to buyer. As mentioned above, in a distribution or supply agreement, the buyer assumes responsibility, whereas in an agency agreement, risk remains with the supplier.
- **Marketing and Branding Obligations:** Distribution agreements often impose marketing and promotional requirements on the counterparty. Businesses should ensure that these obligations are clearly defined and enforceable.

- **Regulatory Compliance:** Certain products (e.g., medical devices, cosmetics, food, etc.) are subject to regulatory approvals and labeling requirements. Contracts should specify who bears responsibility for compliance (for example, whether these obligations would be imposed on the distributor).
- **Dispute Resolution and Governing Law:** Given the cross-border nature of these agreements, and the possibility that classification of the type of agreement may vary between jurisdictions, businesses should carefully consider jurisdiction, and governing law to minimize risks in case of disputes (or misclassification by the parties).
- **Tax implications:** While choosing the agreed contractual structure, the parties should examine various potential direct and indirect tax consequences, including Withholding Tax, Permanent Establishment risks, VAT obligations, Customs liabilities and Purchase Tax liabilities.

International trade agreements play a critical role in structuring global business relationships. Choosing the right contract type and drafting clear provisions can help companies mitigate risks and optimize their international operations.

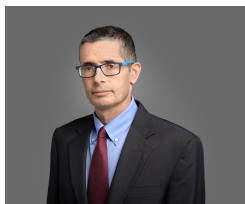
Our firm regularly advises on trade agreements and can assist in tailoring agreements to your business needs. Please feel free to reach out for further guidance.

This update is intended to provide general and concise information only. It does not constitute a full or complete analysis of the issues discussed, does not constitute a legal opinion or legal advice, and should not be relied upon as such.

Key Contacts



Asaf Avtuvi
Partner



David Goldman
Partner



Rebecca Genis Shepetovsky
Partner