

The 5 Biggest Challenges when Working with a Distribution Partner in the United Arab Emirates

The United Arab Emirates (“UAE”) has become a significant economic power in the Arab world. The country is well known for its political stability, a market-driven and liberal economic policy, a diversified economy and an excellent infrastructure, making it a promising market for you as a foreign manufacturer. To successfully distribute your products in the UAE, there are various options available. On the one hand, you can handle the marketing and sale of your products yourself by setting up your own company in the UAE. On the other hand, you can assign a local distribution partner. Regardless of which option you select, you should familiarise yourself with the legal, economic and cultural characteristics of the UAE. From our experience in dealing with distribution-related mandates, foreign manufacturers typically face the following five challenges in the UAE:

Challenge 1

Selecting the right distribution partner

It is essential to select a distribution partner that is the right fit for your products and needs. Such choice determines how successful you will be in selling your products in the UAE.

From the perspective of a foreign manufacturer, the ideal distribution partner is based in the UAE and is already established and experienced in the specific industry, yet does not distribute competing products. It maintains excellent business contacts with potential customers in both the private and public sector and enjoys a high reputation in the market, particularly among other foreign manufacturers. If necessary for the distribution of your products, the ideal distribution partner has technical expertise and maintains an infrastructure for providing after-sales service - which is in high demand in the UAE - at the quality standard you require. Further, the ideal distribution partner generates sufficient levels of local added value to improve the competitiveness of your products in local tenders, such as with respect to the In-Country Value Program in the Emirate of Abu Dhabi.

Foreign manufacturers typically get to know distribution partners at trade fairs. You are well advised to not act hastily in these encounters as decisions in such circumstances are often driven by a certain euphoria of a successful trade fair participation and rather grandiose promises of the potential distribution partner rather than being based on a profound analysis. Above all, you should avoid signing documents in any situation of surprise. In such scenarios, caution should be exercised irrespective of the length of the document presented.

UAE-based foreign chambers of commerce and business councils as well as industry associations provide support in seeking out a suitable local distribution partner. From our experience, it is also useful to share experiences with other foreign manufacturers from the same or a similar industry and market sector.

As soon as you have shortlisted a candidate, you should get firsthand impressions on the ground and verify all information

obtained. Experience shows that the time spent on selecting a distribution partner pays off in the long run.

Challenge 2

Negotiating effectively

Once the right distribution partner has been selected, foreign manufacturers have to negotiate in a goal-oriented manner. It is essential that you carry out negotiations with distribution partners as equal partners. There is no need for being hesitant to voice your ideas and take clear positions, even if you are dealing with an Emirati or another Arab business partner.

However, foreign manufacturers should enter into negotiations only after having done their research ahead of time. In-depth knowledge regarding the local business culture enables you to understand the conduct of your counterpart and avoid common mistakes. Hence, familiarise yourself with the local laws and the economic and cultural customs in the UAE at an early stage.

Whenever the manufacturer and the distribution partner face substantial disagreements early on in the negotiation stage, we recommend refraining from concluding a contract. You should instead continue searching for a more suitable partner with whom a trouble-free and trusting contractual relationship can be expected.

Challenge 3

Concluding a balanced agreement

A foreign manufacturer should ensure to only enter into a contract that protects and benefits its interests. Missing or poorly drafted clauses or unnecessary registration of the agreement almost inevitably have a negative impact on your commercial success in the UAE.

In this respect, it is important to know that many local distribution partners encourage or even consider it essential to register the distribution or commercial agency agreement in the Commercial Agency Register kept with the UAE Ministry of Economy. However, only a few manufacturers realise that such registration entails the mandatory application of the UAE Commercial Agency Law. Such law is highly protective of



distribution partners (and applies regardless of whether the parties to the agreement agreed on the applicability of a foreign law) and consequently rather detrimental to the interests of the foreign manufacturer. As an example, once the distribution partner is registered, the manufacturer is required to pay commission for sales made within the territory regardless of whether the distribution partner has contributed to such sales. Upon registration, the distribution partner is further entitled to prevent the import of the manufacturer's products covered by such registration by third parties and even by the manufacturer itself into the UAE.

From the perspective of a foreign manufacturer, a registration in the Commercial Agency Register is only recommended if mandatory local administrative practice requires such action. For instance, a registration may be a compulsory requirement for participating in public tenders. Local civil defence authorities also require registration in many cases for reasons of risk prevention, especially with respect to technical products. Apart from that, registration may prove necessary from a compliance perspective given that there are cases where UAE courts have considered unregistered distribution or commercial agency agreements void pursuant to the Commercial Agency Law.

It is further important to consider the scope of application of an agreement. Many foreign manufacturers, being unaware of the options available, grant extensive powers to the distribution partner for no reason. In our practice, we have often seen clients furnishing distribution partners with exclusive and timely unlimited distribution rights for their entire product range and in relation to all seven Emirates of the UAE. You should instead reflect carefully which of the seven Emirates of the UAE and which products from your portfolio should be reasonably assigned to the distribution partner and for which period of time. You should further assess if the assignment of an exclusive distribution right is actually needed.

Additionally, you are well advised to include detailed clauses related to specific obligations of the distribution partner. Otherwise, failure to act or, in your view, other misconduct by the distribution partner may not constitute a breach of contract and, hence, may not be invoked as grounds for a future contract termination.

Challenge 4 **Insisting on contractual compliance**

Another important aspect of working with a distribution partner in the UAE is to insist on contractual compliance. Clients often fail to address even continuing breaches of contract by a distribution partner at all or in the right way.

It would be more appropriate and beneficial to the manufacturer to openly address such breaches in a timely manner and to urge conduct that is consistent with the contractual terms. In

addition, the manufacturer should offer support (such as trainings) and document communication that will be admissible as evidence in court. Otherwise, you might be legally incapable of withdrawing from the contract in good time or even at all in spite of ongoing breaches of contract.

Should support measures fail and should a termination of the contract prove to be impossible for legal or economic reasons, the manufacturer might want to consider providing the distribution partner with even more enhanced support by setting up a local subsidiary. For instance, manufacturers could establish a so-called representative office from which employees of the manufacturer could further assist the distribution partner in marketing the products.

Challenge 5 **Terminating the contract**

Finally, foreign manufacturers should inform themselves which criteria need to be fulfilled for terminating the contract prior to concluding the same.

If the distribution or commercial agency contract is governed by UAE law, termination is subject to special conditions.

Registered distributorships or commercial agencies can only be terminated or not renewed in exceptional cases. Termination or non-renewal is only permitted for a material reason. For instance, repeatedly failing to meet sales targets, selling competing products or acting in a manner that damages the reputation of the foreign manufacturer may constitute such material reason. However, it is important to bear in mind that local authorities and courts are extremely reluctant to recognise reasons for termination or non-renewal of a registered distribution partnership. Moreover, as a rule, such contracts can only be terminated or not renewed against comparatively high compensation payments by the foreign manufacturer. Additionally, for the duration of legal proceedings, the distribution partner retains its exclusive distribution right, its right to commission and its right to prevent parallel imports into the UAE. At worst, the foreign manufacturer will be denied the possibility to distribute its products in the contractual territory for the entire duration of the dispute.

In the past, UAE courts have also tended to generally award some compensation to unregistered distribution partners upon termination (if the courts considered the unregistered distribution partnership to be legally effective). Even if parties expressly agree in the contract that neither party should be entitled to compensation upon termination, it cannot be entirely ruled out that a UAE court would award the distribution partner compensation regardless.

Hence, in the event of a conflict, manufacturers should always consider entering into a settlement agreement rather than



terminating the agreement or, in case of registered contracts, notifying non-renewal. The advantage of such settlement agreement is a comparatively quick and clean break with the distribution partner in return for a compensation payment. A settlement agreement can, thus, avoid long and costly proceedings. However, you should know from the outset that distribution partners generally tend to claim a high compensation in return for dissolving the contractual relationship. As these claims often lack a realistic basis, manufacturers have to exercise caution when entering into respective negotiations. Due to legal particularities, legal advice should always be sought before commencing talks with the distribution partner.

Conclusion

The appointment of a distribution partner in the UAE is usually associated with significant advantages for foreign manufacturers as it allows for a swift market entry and product

placement because of an already existing distribution network and business infrastructure, such as sales premises, warehouses and offices, as well as an established insight into local customs.

In order to fully reap these benefits, foreign manufacturers should also be aware of existing challenges and take the following into consideration when dealing with local distribution partners:

- Select your distribution partner carefully.
- Negotiate confidently and with clear objectives.
- Ensure that the distribution or commercial agency contract protects your interests.
- Notify your distribution partner consistently in writing about any breach of contract on its part.
- Have a strategy for contract dissolution in place.

Do you have questions? – We would be glad to answer them!

From our office located in the heart of Dubai, our team of German attorneys has been advising small and medium-sized companies, corporations and individuals on the laws of the United Arab Emirates for more than 18 years. Our areas of expertise include corporate law (in particular business set-up), commercial agency law, employment law as well as tenancy and real estate law. We would be happy to attend to your questions as well. Contact us!

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