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Introduction:

A supplier, when considering the distribution of goods, will need to decide whether to appoint an agent or a distributor. There are many factors that need to be considered when making this decision and drafting such contracts. The primary difference between the two contracts is that an agent acts on a principal-agent basis and a distributor acts on a principal to principal basis. The agency and distribution relationships are primarily governed by the contract entered into between the parties. The Indian Contract Act, 1872 ("**Contract Act**") governs the fundamental principles of a contract. Contracts

establishing a relationship of the agency or distributor are very common in businesses in India and can be express or implied.

There is no specific government body or authority that regulates the relationship between the supplier, distributor and / or the agent. However, certain government agencies have regulatory roles based on specific legal issues where the government body has a legislative mandate to enforce any specific law. For example, the provisions of the Foreign Exchange Management Act, 1999 are attracted whenever there is involvement of foreign currency and payment-related issues for import or export of goods into or out of India. Further, issues pertaining to warranties, transfer of risks and ownership of goods are governed by the provisions of the Sale of Goods Act, 1930. The quality of goods and trade practices are governed by the Consumer Protection Act, 1986, which provides for various safeguards against unfair trade practices, defects in goods and deficiency in services. Further, to safeguard the intellectual property of the supplier, the provisions of the Trade Marks Act, 1999 and the Patents Act, 1970 are of relevance.

Freedom of Contract:

The Contract Act being a British Indian law is heavily influenced by the common law principles and favors fair and just transactions between individuals. Under Indian law, freedom of contract is a judicial concept which holds that contracts are based on mutual agreement and free choice. Therefore, contracts are not to be hampered by external control such as governmental interference or third parties. The doctrine is based on the presumption that individuals are free and equal.

The apex court in a decision stated that *“If a clause in a contract is found unreasonable or unfair, one must look at the relative bargaining power of the parties”*. This shows that the Indian courts are keen on protecting the freedom of the parties in terms of their equality. The courts have used phrases like *“So unconscionable so as to shock the conscience of the Court”* in order to justify any interference.

For agency and distribution contract to be legally binding and enforceable in India subject to fulfilment of the above criteria's, parties have complete freedom to agree to such terms as they deem fit in their contracts and the law does not lay down any specific terms to be inserted in the contracts.

Exceptions:

The distribution and agency agreements must not be in restraint of trade or legal proceedings against any party to such agreements. Under Indian law, any agreement by which anyone is restrained from exercising a lawful profession, trade or business of any kind, is prima facie considered void to the extent of imposition of such restraint. Every agreement, by which any party thereto is restricted absolutely from enforcing his rights under or in respect of any contract, by the usual legal proceedings in the ordinary tribunals, or which limits the time within which he may thus enforce his rights, is considered to be void to such extent.

Absent or Ambiguous Terms:

Indian courts read into the interpretation of contracts and do not interfere by re-writing the contracts. In case there are ambiguous terms present in the contract the court might use the following to help them understand the parties' intentions:

- **Common Usage:** Vague words can be clarified using the common usage of the term, or the dictionary meaning. This is useful for everyday non-technical terms.

- **Parol Evidence:** Parol evidence refers to oral agreements that were reached prior to the formal signing of the contract (as in negotiations). In some cases parol evidence can be introduced in court, though this may vary by case.
- **Industry Usage:** Courts may have to rely on the way a word is commonly used in a particular industry. This is common for words that have a highly technical meaning specific to a certain industry or business
- **Reasonableness:** Courts will also factor in whether one interpretation is more reasonable than another. If an interpretation leads to an impossible or unlikely outcome, a different interpretation will be favored.
- **Implied Meanings:** A court may simply “fill in the blank” and imply that a word has a certain definition, especially where terms were left blank. However, they will avoid this if it is certain that the parties intended the contract to be silent on a certain point.

In most jurisdictions, and also in India, ambiguous contracts/terms are said to be resolved “against” the party that drafted the contract. Depending on case to case basis, the party that did not write the contract will sometimes receive the benefit of the doubt regarding ambiguities. This is because it is assumed that the party that drafted the contract may have more knowledge and bargaining power compared with the other.

Further, it is a common norm in India to insert a severability clause, under which if a clause is ambiguous or unenforceable, the parties shall negotiate in good faith to replace such a clause with an alternate clause having the closest economic effect to such ambiguous or unenforceable provision.

Oral Contracts:

Oral contracts consists of words, gestures, symbols by which one party conveys a promise or a set of promises to another which on acceptance by the other party, becomes a valid oral contract. They may be express or implied in nature. Valid oral contracts are legally enforceable in the Indian court of law. However, it is not of great evidentiary value as the agreement is understood through the word of mouth and obtained via secondhand knowledge. In case of a dispute or a suit, it is difficult for the court to ascertain the true nature of facts and terms of the agreement, without the invasion of bias.

An oral contract by which itself the parties intend to be bound is valid and enforceable, unless required by any other law to be in writing; but, oral agreement require a clear satisfactory evidence about formation and contents. Where a party seeks to enforce an oral agreement, heavy burden of proof lies on such party to prove that a contract is concluded, and the terms of the contract were meant to be given effect to.¹

An oral agreement is as equally valid, as a written one. If an oral agreement falls under the ambit of the requirements stated in section 10 of the Contract Act, such oral agreement are legally valid.

Competition/Antitrust/Non-Compete Covenants:

The Indian Law prohibits business arrangements that could form a nexus within the chain of supply, distribution, storage, acquisition, control of goods, or provisions of services. Anti-trust regulations prevent

¹ Vol I of Indian Contract & Specific Relief Acts by Pollock and Mulla, 12th Edition

large multinational corporations, both domestic and international, from gaining undue advantage in the Indian market, and also seek to protect small enterprises. Issues related to competition law under a contract are enforced by the Competition Commission of India (“CCI”), which ensures that any contractual arrangement between the parties does not lead to any appreciable adverse effect on competition in the relevant Indian market or creates any barriers to new entrants or forecloses competition and such like. Thus, CCI does not allow concentration of economic power in few hands that is prejudicial to public interest and therefore curtails monopolistic and restrictive trade practices.

Indian courts have drawn a clear distinction between non-compete covenants after the term of the agreement and post the term of an agreement. To determine enforceability of such covenants, the courts consider the question whether the covenant is or is not in restraint of trade. It is well established that the non-compete covenants operative during the period of a contract are generally enforceable if the restriction is reasonable and is required to enhance the level of service to the customers and efficiently manage the sale of products. However, non-compete covenants, after the expiry or termination of the contract, are difficult to enforce as they are considered as a restraint in exercising a lawful profession, trade or business. An exception to this restriction is an agreement not to carry on a business of which the goodwill is sold.

Tax Considerations:

Article 265 of the Constitution of India provides that "no tax shall be levied or collected except by the authority of law". Therefore, no tax can be levied or collected in India, unless it is explicitly authorised by way of legislation.

The major tax considerations for suppliers in India are corporate income tax, and the treatment of tax incidence under the Double Taxation Avoidance Agreement (*if applicable in relation to the supply*) entered into between the India party and the foreign supplier as Indian laws allow tax to be withheld in respect of any sum to be paid to a foreign supplier. The foreign supplier should also consider other taxes such as the Goods and Services Tax (“GST”) and customs duty (for import of the products).

Other Issues:

Contract Termination

Care should be taken to incorporate reasonable terms for termination of the contract by a party; otherwise the affected party generally tends to challenge the termination of contract on the ground of unreasonableness. However, generally, the courts in India respect and uphold the contractual terms, if the contract is not totally unbiased.

Contract termination without cause is permitted in India, provided that the terminating party gives a reasonable notice or compensation to the other party. The supplier is under no legal obligation to renew the contract after the contract terminates by passage of time. Indian courts have held that even in the absence of a termination clause in the contract enabling either party to terminate the agreement, the contract can be terminated even without assigning any reason and by serving a reasonable notice or paying compensation in lieu of notice. Though the contracts are personal in nature, a party can file for damages in court of law for any illegal termination of the contracts.

Confidentiality

Confidentiality provisions in agreements, during and after the term of such agreements, are generally enforceable in India provided the agreement does not restrain anyone from exercising a lawful profession, trade or business of any kind.

There is no specific legislation to protect confidential information. However, the courts have upheld protection of such information on the basis of the terms and conditions of the contract, and principles of equity and common law action for breach of confidence.

Exclusivity & Territory

Under the Indian law, generally, an exclusive distribution agreement, including an agreement that limits, restricts or withholds the output or supply of any goods or allocates any area or market for the sale of goods, is considered as an anticompetitive agreement, if such agreement causes, or is likely to cause, an appreciable adverse effect on competition in India. Matters related to anticompetitive agreements are decided on a case-to-case basis, which involves enquiry into the purpose and effects of an agreement, whether the restraint imposed is such that it merely regulates and promotes competition or is such that it may suppress or even destroy competition. Therefore, a supplier can restrict the geographical area or categories of customers if the agreement is in compliance with the above provisions of competition law.

Further restrictions on distribution and agency agreements have been discussed in **Competition/Antitrust/Non-Compete Covenants** above.

Dispute Resolution and Arbitration

As a common practice in India, resolution of disputes in commercial arrangements / transactions *via* litigation is not advisable even if foreign law is chosen as the governing law. Orders passed in most jurisdictions (e.g. USA) are not recognized in India. India recognizes very few countries as reciprocating countries and judgements of courts of such countries are recognized as an equivalent judgement offered in the Indian courts. Some of the reciprocating countries are UK, UAE, Singapore etc.

Arbitration is a preferred mode of resolving the disputes due to various advantages including foreign arbitral awards being recognized and enforced in India as India is a signatory to New York Convention. The framework of arbitration in India is based on maximum party autonomy with minimum judicial intervention. A large number of commercial contracts in India contain an arbitration clause as a part of the parties agreement to resolve their disputes through arbitration rather than approaching courts.

Stamp duty

In India, stamp duty is payable on specified instruments in accordance with applicable Central law (Indian Stamp Act, 1899) or applicable State level stamp duty laws (Maharashtra Stamp Act, 1958, Karnataka Stamp Act, 1957 etc.), on a fixed or on ad valorem basis.

It is important to ensure appropriate stamping of the instruments / documents in accordance with applicable laws to ensure enforceability in the court of law in India and/or avoid impounding of such documents. Instruments / documents which are not duly stamped are inadmissible as evidence in the court of law in India. Penalty is levied on under stamped or unstamped documents and such penalty varies from state to state. It is not uncommon to have an instrument / document adjudicated by the designated

authority prior to its execution to avoid any interpretation issues at a later date over the quantum of duty leviable. Registration and payment of Stamp duty makes a document legal and creates a right on the document holder.

Resources:

- <http://legislative.gov.in/actsofparliamentfromtheyear/indian-contract-act-1872>
- https://www.cci.gov.in/sites/default/files/cci_pdf/competitionact2012.pdf
- https://www.rbi.org.in/scripts/BS_FemaNotifications.aspx?Id=10256
- http://www.ipindia.nic.in/writereaddata/Portal/IPOAct/1_43_1_trade-marks-act.pdf
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- http://legislative.gov.in/sites/default/files/A1930-3_0.pdf
- <https://gettingthedealthrough.com/area/75/jurisdiction/13/distribution-agency-india/>

Firm Description:

Link Legal India Law Services is a full service law Firm with offices in Delhi, Mumbai, Bengaluru, Gurugram, Hyderabad and Chennai. The Firm was established in 1999.

The Firm is involved in major headline transactions, advising clients on most complex matters and disputes in diverse practice areas and sectors. The Firm has extensive experience of advising clients on complex matters pertaining to infrastructure, private equity, mergers & acquisitions, exchange control & foreign investments, project financing, litigation, arbitration & mediation, labour & employment, policy & regulatory, real estate and contract management in diverse sectors including airports, transports, roads, ports, real estate, power, aviation, water, media, information technology, telecommunications, pharmaceutical, consumer goods, mining, insurance and banking. We also provide assistance in formulating and implementing entry strategies.

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