

PROTECTION OF REPRESENTATIVES OF FOREIGN FIRMS

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CHARACTERISTICS OF “THE LAW”

As part of Costa Rica’s commitments under DR-CAFTA, “The Law” has been significantly modified.

Distribution and representation/agency relationships may now be set up for a defined term. Additionally, “the Law” now recognizes the parties’ right to unilaterally terminate their relationship at any time by prior written notice without the need to provide justification.

For a firm to avoid paying compensation when it terminates or modifies a distribution or representation/agency agreement before the contract’s expiry date, the following justifiable causes are required:

When:

- A distributor or representative/agent commits any crime against the foreign firm.
- A drop or stagnation in sales for a prolonged period leads to a Costa Rican Court’s judicial declaration against the distributor or representative/agent for negligence or ineptitude.
- The distributor or representative/agent breaches either the obligation to secrecy or to safeguard to the foreign firm’s confidential and proprietary information.
- The distributor or representative/agent commits serious breaches of their legal and contractual obligations towards the foreign firm.
- The foreign firm terminates the contract either when it expires or, under the contract’s terms, sends a prior notice of early termination to the distributor or representative/agent.
- The contract does not provide for an alternative prior notice term, the foreign firm may terminate early with a prior notice sent to the distributor or representative/agent at least ten months before the desired termination date.

The fixed mechanism for calculating indemnification to the agent/representative or distributor, when the contract has been terminated or modified for reasons other than the above, has been annulled. New article 10 bis provides that the general breach of contract rules apply under the Costa Rican civil and contract law for indemnification claims for damages arising from agency/distribution relationships.

Additionally, in cases of litigation, the foreign firm is no longer obligated to post a bond guaranteeing the amount of damages that the distributor or representative/agent claims. Under “the Law”, the judge – upon the interested party’s request - may only order the foreign firm to post a bond when evidence exists that the

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foreign firm has insufficient assets in Costa Rica to cover any eventual damages it may be ordered by the court to pay.

Another important change is that distribution or representation/agency relationships are no longer presumed exclusive. The relationship is now presumed non-exclusive; unless the parties, within the contract, have expressly agreed on exclusivity.

Additional characteristics of “The Law”

- It is mandatory to apply Costa Rican law. Controversies arising from this type of contract must be resolved before Costa Rican courts or by arbitration either within or outside Costa Rica.
- Agent/distributor’s rights under the law cannot be waived.

The statute of limitation is two years from the date on which the claim arises.

- Costa Rican courts tend to favor local representatives/distributors if the foreign firm does not provide clear and convincing evidence for terminating any contract.

Advice n Setting Up Distribution/Agency Agreements

- Negotiate your distribution/agency agreements carefully (Do not assume a template format.) Have U.S. counsel coordinate with local counsel.
- Address the following issues:
 - Consider Alternate Dispute Resolution (arbitration, preferably in equity) in another country under foreign law.
 - Always include a clause in the agreement that states conflicts must be brought before an arbitration authority outside Costa Rica and that this authority must decide in equity.
 - Be especially sensitive to the wording of any unilateral anticipated termination clause without cause. It is important that the contract provides the prior notice period that the parties must adhere to when they terminate their commercial relationship.
 - Define the contract’s territory
 - Clarify that the foreign firm retains its rights to both marketing and distributing its goods or services

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directly (or through other authorized persons/entities) within the territory (relationship non exclusivity) and exercises this right.

- Establish realistic yearly sales' targets and demand that the distributor/representative complies.
- Provide the agent/distributor with comprehensive obligations regarding confidentiality and guarding of private information.
- Establish with the agent/distributor significant Intellectual Property obligations.
- Consider and reevaluate the cost of paying the indemnification for breach of contract annually and factor this cost into the sales commission schedule (although there is no case law on this, labor courts have considered the practice of paying severance yearly consistent with labor law obligations).
- Build into the contract as many agent/ distributor moral obligations as possible and have the contract define breaches as severe. These obligations will provide moral negotiating leverage; thus local courts or arbitrators are more likely to accept them.
- Consider e-commerce and use only a sales representative in Costa Rica.