

# INTERNATIONAL LEGAL RISK TUNE-UP

Sales Terms,  
Agency and Distribution Agreements,  
Dispute Resolution Clauses

International Trade Association  
of Greater Chicago

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## Our Agenda

1. Are You Following Best Practices for International Sales Terms and Conditions?
2. Do Your International Agency and Distribution Agreements Carry Unacceptable Hidden Risk?
3. Contract Dispute Resolution Clauses - Have These Been Scrutinized for Cross-Border Effectiveness?

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## Tune-Up Focus – The Hidden Risks

### Typical “International” Contract for an Illinois Company:

1. “Illinois Law and Chicago Courts” – presumed safe and secure
2. “Freedom of Contract” – a common assumption

## International Legal Risk Tune Up

*Why Now?*

## Why Now?

- ♦ In recessionary times, **many mid-sized and emerging international companies have scaled-back their international expansion** through foreign offices and direct investment
- ♦ Yet, companies have continued to expand through the sale of products and the appointment of agents and distributors
- ♦ **2012 may be an excellent time to take a fresh look at the international legal health of your company as the global economy gradually improves**

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## Why Now?

- ♦ Investing time and expertise in a good sales or agency/distribution contract is **a critical revenue-generating tool** – at a time when continued growth is key:
  - limit liabilities and contract breach claims
  - minimize disputes and enforcement action
  - cap uncollected accounts receivables
  - avoid reputation-damaging publicity

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## International Legal Risk Tune-Up

### *Deceptively Simple Contracts?*

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## Deceptively Simple?

Company Perspective. International sales may represent a simplified and less expensive alternative for entering a foreign market, but also for getting out

**These agreements look like the kind of agreements used in a company's domestic market - what can go wrong?**

US business is at a special disadvantage - relative freedom of contract, lack of local dealer-protection, absence of currency and other cross-border issues

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## Deceptively Simple?

Lawyer Perspective. Those familiar with cross-border joint ventures, M&A deals and other sophisticated transactions **may underestimate the issues in a sales or agency/distribution agreement**

True, there is not the same in-depth connection to another jurisdiction or depth of relationship with a partner, such as is found in a cross-border joint venture

Yet, the following attitude is all too common: "Let's let the associates tackle the simple stuff."

## Where to Start?

*Whose Draft, Local Counsel  
and Process*

## Whose Draft, Local Counsel and Process

### Templates and Models - Where to Start?

- ♦ Does client have a avored template for US use?
  - If it does, really possible to use a US template yet take into account local law and practice?
- ♦ Has client been given a draft by the counter party and is it worth using?
- ♦ Should local counsel be asked for their version and then add terms favored by client?

## Whose Draft, Local Counsel and Process

### Not just "process" issues - gets to some fundamental fallacies and assumptions

- ♦ Do consistencies in cross-border agreements outweigh the differences? China is not Mars and France is not Venus. There are fewer North Koreas left out there with semi-unique legal frameworks
- ♦ What is too little and too much emphasis on the cross-border aspects of basic agreements, and what of local law?
- ♦ Do "global law firms" dominate the business of cross-border agreements? Trends and large company practices

## WHY DO I DO THIS?

A Quick Personal Journey

- . . . from a Global Law Firm,
- . . . to 3 Years in Seoul with Local Counsel
- . . . and on to Creating an In-House International Counsel Role

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## International Sales Terms and Conditions

### *Mandatory Local Law and Cross-Border Sales Terms*

#### *Are You Following Best Practices?*



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## Cross-Border Sales Terms

### Warranties.

What laws governing product warranties? Manufacturers and distributors may guarantee a product's:

- **quality and performance**
- **fitness for its intended purpose**
- **lack of infringement on the intellectual property rights**



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## Cross-Border Sales Terms

### Warranties.

When does a problem surface?

- ♦ major **claims based upon a product failure**, or
- ♦ in an M&A context, **loss of a deal or a purchase price reduction** when a purchaser discovers that a company has not protected itself against such claims

## Cross-Border Sales Terms

### Warranties.

- ♦ Example 1: DISCLAIMER OF OBLIGATION AS TO CONFORMITY OF THE GOODS. The parties agree that the seller undertakes no obligation with respect to the conformity of the goods to the contract except as otherwise provided in this contract document. In particular, THE PARTIES AGREE TO EXCLUDE ALL IMPLIED WARRANTIES, INCLUDING THE IMPLIED WARRANTIES, OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE
- ♦ Example 2: SELLER EXPRESSLY DISCLAIMS ALL WARRANTIES, EITHER EXPRESS OR IMPLIED, INCLUDING IMPLIED WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR PURSUANT TO ARTICLE 35(2) OF THE CISG.

## Cross-Border Sales Terms

### Warranties.

Is a US warranty enforceable in other countries?

What about against consumers?

## Cross-Border Sales Terms

### Warranties.

**EU DIRECTIVE 1999/44/EC - certain aspects of the sale of consumer goods and associated guarantees**

#### Article 3, Rights of the consumer

2. **In the case of a lack of conformity, the consumer shall be entitled to have the goods brought into conformity free of charge by repair or replacement**, in accordance with paragraph 3, or to have an appropriate reduction made in the price or the contract rescinded with regard to those goods, in accordance with paragraphs 5 and 6.

## Cross-Border Sales Terms

### Warranties.

#### Article 5, Time limits

1. **The seller shall be held liable under Article 3 where the lack of conformity becomes apparent within two years as from delivery of the goods.** If, under national legislation, the rights laid down in Article 3(2) are subject to a limitation period, that period shall not expire within a period of two years from the time of delivery

## Cross-Border Sales Terms

### Warranties.

**Apple:** Worldwide, all Apple hardware had come with a one-year warranty. On most products, that warranty can be extended to 2 or 3 years with AppleCare

- ♦ What about the EU Directive? Manufacturers must warrant goods for two years?
- ♦ Consumer groups in 11 countries sent letters to national regulators asking for action against Apple regarding its warranty practices

## Cross-Border Sales Terms

### Warranties.

- ♦ **In 2011, Apple was fined \$1.2 million by Italian regulators** over allegations that the company **hadn't adequately disclosed the standard two-year warranty that is required by Italian law**
- ♦ **Apple has now agreed to introduce 2 year warranties on its products for those countries covered by EU consumer law**

## Cross-Border Sales Terms

### Limitations of Liability.

Disclaimer of all liability, even direct damages?

Even if due to gross negligence or intentional misconduct?

## Cross-Border Sales Terms

### Limitations of Liability.

Example: "Save as [complying with the seller's standard specification]:

- ♦ **all conditions and warranties**, whether express or implied by statute, common law or otherwise howsoever, as to the quality or fitness for purpose of the goods or their correspondence with description **are hereby expressly excluded to the fullest extent permitted by law**; and
- ♦ **the seller shall be under no liability for any loss or damage (whether direct, indirect or consequential)** howsoever arising which may be suffered by the buyer by reason of any defect of whatever kind in the goods."

## Cross-Border Sales Terms

### Limitations of Liability.

**UK:** (Balmoral Group Ltd v Borealis (UK) Ltd [2006] EWHC 1900 (Comm))

- ♦ Any attempt to exclude liability where the product was unsuitable is unlikely to be successful.
- ♦ **In a UK business context, cannot simply assume that written standard exclusion of warranty terms will be enforceable.** To be enforceable, the parties must be shown to have made an obvious, conscious decision to allocate risk to the buyer.
- ♦ This test of reasonableness applies only in a business-to-business context - **a clause purporting to exclude liability under an implied warranty in the act will be wholly ineffective against a consumer.**

## Cross-Border Sales Terms

### Limitations of Liability.

#### China:

- ♦ Chinese Contract Law (Art. 39 and 40) - requires that a party providing the standardized contract shall bring to the attention of the other party any clause that releases or limits liability. Contract terms may be invalid and not enforceable
  - **Cannot exclude damages due to gross negligence or intentional acts.** Art. 53
  - **Exclusion of incidental and consequential damages may be invalid.** Party is entitled to all losses due to a breach. Art. 107

## Cross-Border Sales Terms

### Limitations of Liability.

#### China:

- ♦ Consumer Protection Law (Art. 24) - **for consumers, contracts may be void if they establish "unfair and unreasonable" regulations against consumers, or alleviate or avoid responsibility for harming the rights and interests of consumers**

## Cross-Border Sales Terms

### Some Other Sales Term Examples (excerpt):

- ♦ Payments. Payment of X – only in US dollars, at what exchange rate and when determined?
- ♦ Delivery Terms. “FOB,” “Ex Works,” etc. When does ownership change hands and when does customer become responsible for damage, transportation, etc.? Incoterms?
- ♦ Notice - Whose “Days”? “X days” for payment, invoicing, termination, etc. Not an issue with calendar days, but with “business” or “working” days - in whose country?

## Cross-Border Sales Terms

- ♦ UN Convention on International Sales (CISG)
- ♦ CISG applies only to the formation of commercial contracts (with some exceptions in Article 2), whether oral or written, for the sale of goods which are manufactured or produced (and not predominantly services) between contracting parties (1) whose place of business (regardless of the contracting parties nationality) are in different States and (2) whose country where they carry on business has ratified the CISG
- ♦ Brazil, Hong Kong, India, South Africa, Taiwan, and the United Kingdom are the major trading countries that have not yet ratified the CISG
- ♦ Unless excluded by the express terms of a contract, the CISG is deemed to be incorporated into (and supplant) any otherwise applicable domestic law(s) with respect to a transaction in goods between parties from different Contracting States.

## CISG Contracting States



## Cross-Border Sales Terms

Dispute Resolution – *CRITICAL* and addressed separately below

Issues Outside of the Contract.

- ♦ Product Registration and Labeling
  - *May be overlooked by counsel handling US issues*
- ♦ Trademark and Patent Issues
  - *May also be overlooked by counsel handling US issues*
- ♦ US Export Controls
  - *The product may be controlled or the purchaser on a black list*



## Cross-Border Agency and Distribution Agreements

### *Mandatory Local Law and Cross-Border Representative Terms*

### *Are You Following Best Practices?*

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## Cross-Border Agency and Distribution Agreements

### *Mandatory Local Law*

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## Local Dealer Protection

### The Issue:

- ♦ Local laws may restrict the termination of a representative through:
  1. Mandatory termination notice
  2. Mandatory post-termination compensation
- ♦ Often a surprise to companies from common law countries such as the US, Canada, Singapore or New Zealand

## Local Dealer Protection

### What Agreements?

Generally Agency Agreements, though Distributor Agreements in some jurisdictions and both in others

### What Clauses?

- ♦ Term – preference for a fixed non-“evergreen” term
- ♦ Termination – clear and complete termination grounds
- ♦ Waivers and Disclaimers – attempt to avoid notice and post-termination compensation
- ♦ Dispute Resolution – preference for common law governing law and non-local arbitration

## Local Dealer Protection - EU

- ♦ Perhaps the best-known framework of termination limitations is found in Europe - EU Directive 86/653 has been enacted into local law of EU member countries with local variations to generally apply to "agency" relationships
- ♦ Generally requires termination notice of 1 month per each year of the relationship up to a maximum of 6-months and post-termination compensation as a form of reward for building the local business on behalf of a principal, to a maximum of 1-year of revenues earned by the "agent"

## Local Dealer Protection - EU

- ♦ Indefinite Term. Notice period generally applies only to agreements of "indefinite" duration which do not specify a definite term or where definite-term agreements have been "rolled-over" into successive periods
- ♦ Not Applicable if Breach/Bankruptcy. Both the notice period and compensation entitlement may not apply if the agreement is terminated for reasons such as material breach or an event of bankruptcy

## Local Dealer Protection - EU

- ♦ Mandatory and Non-Waivable Aspects of Local Law.  
May be difficult to circumvent even through an application of a contractual choice of foreign law and foreign courts or arbitration
- ♦ "Agency" Especially, But Depends on Local Law.  
"Agency" is typically a party which acts in the name of its "principal," with an agreement between such "principal" and the local buyer or end-user and with a "commission" earned by the "agency" in a sale of goods context. However, a "distributor" (a party that buys products for its own account and re-sells) may also fall within local law coverage even in countries outside of Belgium

## Local Dealer Protection – Practical Tips

- ♦ Limit the initial term, but renewals can turn into an indefinite term agreement
- ♦ Can choice of law and dispute resolution help limit mandatory local law issues and avoid local litigation?
- ♦ Obligations upon expiration or termination to include cessation of representation of foreign party and products, and assignment to foreign party of all approvals and licenses related to the marketing and sale of the products
  - Some special challenges in the Middle East

## Cross-Border Agency and Distribution Agreements

### *Competition Law Issues*

## Competition Law Issues

### The Issue:

Clauses deemed anti-competitive may be prohibited

- ♦ Resale price maintenance – distributor or reseller, is required to charge a minimum amount for the product or licensed items
- ♦ Territorial restrictions – the representative is required to sell only in its territory and not make sales outside of it, yet some countries prohibit the imposition of restrictions on “passive sales” from unsolicited orders outside of the country
- ♦ Non-compete provisions – can these be extended beyond the term of the agreement, and if so for how long, and are there limitations even during the term of the agreement?

## Competition Law Issues

### What Agreements?

For example, Distributor Agreements, though Agency Agreements in some jurisdictions and both in others

### What Clauses?

- ♦ Sales Price – can be resale price maintenance
- ♦ Territory – watch absolute prohibitions on sales outside of defined territory
- ♦ Non-Competition – consider limiting length of non-competes even during the term and exercise special caution with post-termination non-competes

## Competition Law Issues – EU

Article 81(1) of the EC Treaty: any provision of an agreement or any concerted practice which affects trade between member states and which has as its object or effect the prevention, restriction or distortion of competition within the European Union is prohibited

Certain provisions which are thought to have a beneficial effect outweighing any anti-competitive effects may survive by conforming with block exemption regulations

## Competition Law Issues – EU

- ♦ "Safe-Harbor" if No Hardcore Clauses. Reseller/distributor agreements where the market share of the supplier is under a certain threshold percent are presumed legal unless certain "hardcore" or "blacklisted" provisions are present – if so, the exemption is invalid
  - Other non-hardcore restraints do not render the exemption invalid but the clauses themselves are void

## Competition Law Issues – EU

Hardcore Restriction 1: Resale Price Maintenance – not allowed to fix the price at which distributor can resell

Hardcore Restriction 2: Territory restrictions which prevent "passive sales" are prohibited – must allow unsolicited orders (due to general advertising or Internet sales) from outside of the territory. Restrictions on "active sales" outside of a territory may be restricted

Not Hardcore but Void: Non-compete provisions which prevent a buyer from reselling goods which compete with the contract goods: had been limited to a duration of 5 years in total during the term and only narrowly permitted up to 1-year post-termination (each subject to verification)

## Competition Law Issues – Practical Tips

Most countries do not have territory limitation restrictions such as those in the EU, but think carefully before appointing a representative for large portions of a country such as China or India, or for multiple countries in a region

## Cross-Border Agency and Distribution Agreements

### *Tax Issues*



## Permanent Establishment – Tax I

### The Issue:

Will a supplier/principal be taxed in a foreign country on income from sales or licenses there?

If there is no business presence in that country, such as through a branch or subsidiary, many may believe there would be no tax in the foreign country

However, the concept of “permanent establishment” recognizes that one can have enough interaction with the foreign country, such as through the presence of employees or conduct of activities, to be deemed taxable

## Permanent Establishment – Tax I

### What Agreements?

For example, Agency Agreements  
Agreements With Technical Assistance, Employee Periods In-Country

### What Clauses?

- ♦ Scope of Activities/Duties of Agent – vulnerable if agent may enter into contracts on behalf of principal
- ♦ Technical Assistance, Warranty Service, Etc. Provided In-Country

## Permanent Establishment – Tax I

- ♦ Interaction with the foreign country sufficient to create a “permanent establishment” can be derived through an agent exercising a specified degree of authority on behalf of the principal
  - Generally a risk if the agent has the authority to conclude contracts in the name of the home country resident and regularly exercises that authority
- ♦ Governed by tax treaties between the home country and the agent’s country. A US tax credit may be available for amounts paid

## Permanent Establishment – Tax I

### ***Example: United States-Korea Income Tax Convention***

#### ARTICLE 8, Business Profits

- (1) Industrial or commercial profits of a resident of one of the Contracting States shall be exempt from tax by the other Contracting State unless such resident is engaged in industrial or commercial activity in that other Contracting State through a permanent establishment situated therein. If such resident is so engaged, tax may be imposed by that other Contracting State on the industrial or commercial profits of such resident but only on so much of such profits as are attributable to the permanent establishment.

## Withholding Tax – Tax II

### The Issue:

Even if the supplier/principal does not have a permanent establishment in the other country which would subject a foreign person to tax on business profits derived in that country, may some categories of income derived from that country still be taxable?

Royalties and interest are two categories of income that may be subject to withholding tax

## Withholding Tax – Tax II

### What Agreements?

For example, Agency Agreements if income is royalty income and agent collects on behalf of principal, and both Agency and Distributor Agreements, if interest is collected

### What Clauses?

- ♦ Definition of Income – specify who is responsible for withholding taxes
- ♦ Payments – specify withholding tax mechanism

## Withholding Tax – Tax II

- ♦ If a company expects a payment of 100 from the other country, and this 100 represents royalties such as from the distribution of music or other copyrightable product, the local customer may be required to withhold a percentage of this amount and pay this to local tax authorities
- ♦ The amount may be zero or in the range of 10 – 15% for many countries if a tax treaty applies, but can be far higher if no tax treaties apply

## Withholding Tax – Tax II

### ***Example: United States-Korea Income Tax Convention***

#### ARTICLE 14, Royalties

(1) The tax imposed by one of the Contracting States on royalties derived from sources within that Contracting State by a resident of the other Contracting State shall not exceed 15 percent of the gross amount thereof, except as provided in paragraphs (2) and (3).

- Royalties derived from copyrights and related rights are limited to 10%
- If the recipient has a permanent establishment in the other country, and the right or property giving rise to the royalties is effectively connected with such permanent establishment, the income is taxed as business profits

## Dispute Resolution

*What Governing Law?*

*Litigation or Arbitration?*

## Dispute Resolution

Typical US contracts will specify a  
US State law and local courts

“Illinois law and Chicago courts”

A problem?

## Governing Law and Dispute Resolution

- ♦ True, foreign litigation can be costly, time-consuming and unpredictable
- ♦ World Bank Doing Business Rankings – Enforcing Contracts
  - Measures the time, cost and procedural complexity of resolving a commercial lawsuit between 2 domestic businesses
  - The dispute involves the breach of a sales contract worth twice the income per capita of the economy, with the assumption that the court hears arguments on the merits

## World Bank Doing Business Rankings – Enforcing Contracts

Economy	Ease of Doing Business Rank	Enforcing Contracts
Singapore	1	12
Hong Kong SAR, China	2	5
New Zealand	3	10
United States	4	7
Denmark	5	32
Norway	6	4
United Kingdom	7	21
Korea, Rep.	8	2
Iceland	9	3
Ireland	10	62
Finland	11	11
Saudi Arabia	12	138
Canada	13	59
Sweden	14	54
Mexico	53	81
China	91	16
Brazil	126	118
India	132	182
Congo, Rep.	181	159
Central African Republic	182	173
Chad	183	163

## Governing Law and Dispute Resolution

- ♦ Governing Law - US or Foreign? Difficult for any party to accept an unfamiliar governing law - often determined based on relative bargaining power
- ♦ Most countries do not object to specifying a foreign governing law
- ♦ For example, Chinese law allows parties to a contract with a "foreign element," including if a party is a foreigner, to choose the law to be applied
  - Chinese law had been mandatory in only a few situations, including (1) Chinese-foreign equity joint-venture contracts and (2) Chinese-foreign cooperative joint venture contracts.

## Governing Law and Dispute Resolution

- ♦ Foreign Court Judgment Enforcement. Enforcement by local courts discretionary based on perceived reciprocity of enforcement in the foreign country and include consideration of public policy grounds for rejecting the foreign judgment
  - The U.S. is not party to international conventions requiring other countries to enforce U.S. judgments
  - World Bank index can also be a rough proxy for the ease of enforcing a US judgment in other countries

## Governing Law and Dispute Resolution

- ♦ Foreign Arbitral Award Enforcement. Arbitration among 130+ New York Convention member countries is enforceable in each others' courts except for limited exceptions such as fraud
  - Arbitration not necessarily faster or less expensive
  - Possibility of "split the baby" decisions
  - Limited discovery
  - Interim remedies, though no appeal rights

## Governing Law and Dispute Resolution

- ♦ Foreign Arbitration - Which Rules? Particularly in New York Convention countries, the parties are generally free to choose the arbitral rules that will apply, though there are preferences depending on the country
  - For example, in China, a New York Convention member in which ICC or other rules may be specified, CIETAC arbitration is respected and may be held within or outside of China. Many US and other foreign arbitrators participate as CIETAC arbitrators
  - For a Chinese contract, consider specifying site of arbitration in Hong Kong or Singapore - neutral and some experience among Chinese parties



## Governing Law and Dispute Resolution

### What about Collecting/Enforcing Locally or Obtaining Injunctions/Interim Actions?

- ♦ Tension between seeking to avoid local courts for purposes of actions which may be imposed by a local party yet finding an efficient mechanism to collect amounts owed or stop infringement in local party's home jurisdiction which can be readily enforced
- ♦ Interim actions may be preserved pending arbitration outcome -- specifically reserve right to seek interim/injunctive relief in a court – to preserve assets or to protect IP

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## InternationalCounsel Background

Established In 1997, Team Members In US,  
Europe and Asia

Team of Former Senior Corporate International  
Counsel – Ideally Suited for Global Contracts

In-Country Support Worldwide

15 Years of Client Success. **Motorola. Samsung.  
Corbis. The Sports Authority. Subway.**

A Single Point of Contact With A Senior  
Team Member Having Full Project  
Responsibility

## Integrated Solutions, Worldwide Support

Best Practice Methodologies Integrate Our  
Collective Judgment With In-Country  
Counsel and Practices

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## Value-Based Fees - 50% – 65% Lower Costs Relative to “Global Law Firms”

Flat Organization of Senior Lawyers, Not Hierarchies of Junior-to-Senior Teams

Methodologies for Limiting Input from Local Counsel in Accordance With Strict Budgets

Avoids Expensive and Unrealistic Levels Of Certainty With Limited Business Benefits

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## Representative Clients – 15 Years of Success



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