



**The Primerus International Outside Corporate
Counsel Practice Group Presents**

International Distribution Agreements

Presented by

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CONTRACT FORMATION

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Contract Formation

- First Question: **Who do You Represent?**
 - Goals and business operation considerations
 - Financial Goals are universal, but what are key elements to your client's business, how are products conveyed, how do payments systems work?
 - Do you understand the business model?

- Looking into the other party:
 - What type of company or entity are you dealing with (legal status)?
 - Is the financial status understood, is there public financial information and/or references?
 - Looking into the basic history of other distribution contracts with the party

- Objective is to find a mutually agreeable document with shared obligations

- Avoid attempting to establish excessive control – leads to questions concerning nature of the agreement and can transform your contract from distribution agreement to one of agency or franchisee status with different legal obligations and considerations

Contract Formation: Supplier vs. Distributor

➤ **Supplier's goals** with contract formation

- The contract must allow/establish satisfactory performance objectives
- Certain objectives for the product or line must be met
- Allow for an “out” in case of changes/problems

➤ **Distributor's goals** with contract formation

- Determining how to balance or establish reasonable performance goals
- Support or obligations (control) regarding services
 - Marketing / Advertising /Accounting
- Will benefit or value be provided in case of contract termination after a network is established?

Contract Formation: Defining Key Issues For The Contract

- **Define what is being provided** - Is this a product or line of products?
 - Determine this for current interests with an eye toward future items or lines
 - Trademark considerations (Will this limit or expand scope?)

- **Define Territory and Specific Rights Conveyed**
 - Want specificity
 - Is solicitation outside the territory addressed?
 - Delves into Exclusivity issues to be addressed elsewhere
 - Consideration of control exerted; who can add or subtract?

- **Define the Recipients** - Who ultimately obtains the item/product/lines
 - General vs. restricted markets; Are there restrictions on solicitation?
 - Returns or defects; Acceptance periods

- **Define Duration** - What term applies for the Distribution Contract?
 - Renewal considerations
 - Termination is considered here, but separate discussion

Contract Formation: Applicable Law

Distribution Contract: What Law Applies and what is the Choice of Law?

- Spell it out clearly. Include possible opt-outs or exclusions. This will impact the contract's interpretation.
- Is it a contract for the 1) sale of goods; is it for 2) rights and services; or 3) mixed use?
In US, each state has basic common law contract cases as well as some adoption of the UCC (Uniform Commercial Code) for contracts regarding the sales of goods.
- Does the contract implicate use of the CISG over the UCC (United Nations Convention on Contracts for the International Sale of Goods) -- 80 States are signatories
 - However, the CISG does not ordinarily apply to agreements solely for distribution, development, licensing, leasing, transportation, shipping, insurance, and finance as well as those specifically dealing with consumer goods.
 - Need to be familiar with its impact
 - CISG can be excluded by agreement of the parties, but need clear language AND to identify the law to govern. (*Asante Technologies v. PMC-Sierra, Inc.*, 164 F. Supp. 2d 1142 (N.D. Cal. 2001))
 - Be aware of key differences between the CISG and UCC as to key differences (i.e. **time for acceptance, specifying price, changes to offer and counter-offers, "battle of the forms"**, etc).

What type of Trade Usage Language is desired? Legal Impact of delivery terms?

- Does the client want familiar terms re state based terms or UCC language?
- Explore options (i.e. INCOTERMS, international commercial terms provided by ICC (International Chamber of Commerce) an excellent foundation of terms, but specify applicable Set and familiarize client with meanings (i.e. "Ex works" = seller delivers when he places the goods at the disposal of the buyer at the seller's premises or another specified place. This is minimal seller obligation with costs and risks borne by buyer.)
- Verify you are not contracting for issues in contravention of local law (see pitfalls)

Contract Formation: Pitfalls

Numerous potential pitfalls exist – keep eyes open and use your resources

- Avoid excessive control scenario...could create a franchise situation where different legal liabilities arise (Registration and Disclosure requirements as well as changes to termination rights)

- i.e. California Corp. Code section 31005(a) dictates that a franchise is a contract/agreement, either express or implied, whether oral or written, between two or more persons which essentially amounts to:
 - (1) Grant a business the right to use the Trademark or business name in their business; AND
 - (2) You require the business to act pursuant to a marketing plan; AND
 - (3) The franchisee is required to pay, directly or indirectly, a franchise fee.

- VS a basic distribution contract where the distributor is allowed to buy and sell a supplier's products; the distributor buys inventory at one price and sells it at a higher price to retailers, who then resell the products to the general public at a retail price.

Contract Formation: Pitfalls

Verify Local Government Rules:

- Is there an local agency requiring approval for distribution agreements?
- Are there local antitrust restrictions imposed by local law?
 - Are there issues of price fixing to consider; minimum price levels or other restraints involved ... these need to be carefully reviewed
- Is an entity recognized under local law as a party required to avoid labor laws?
- Contact a local lawyer to verify avoidance of such pitfalls and avoid attempting to contract away rights guaranteed by local/regional legislation

➤ **Determine Obligation Costs:** Explore possible costs regarding shipping considerations, service requirements, hours or money for reports/reporting

- Are the costs prohibitive? Do the obligations imply excessive control?

➤ **Are Boilerplate Provisions current?** force majeure, notice issues, severability, warranty or warranty exclusions

EXCLUSIVITY

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Exclusivity I: Types of distributionship agreements

- Non-exclusive distribution:
 - Supplier may assign the distribution rights for the products within the stated territory to one or more distributors
 - Supplier may sell the products within the stated territory itself

- Exclusive distribution:
 - Distributor is given the exclusive right to sell the products in a stated territory
 - Supplier may not sell the products itself

- Sole distribution:
 - Distributor is given the exclusive right to sell the products in a stated territory
 - Supplier keeps the right to sell the products in the territory itself / through affiliated companies (right may be limited to certain customers and/or combined with a commission payment to distributor)

- Selective distribution: Non-exclusive, but additional distributors are limited as they need to meet certain criteria (enhanced level of service, know-how, etc.)

Exclusivity II: Sole / Exclusive distribution

- Advantages (Supplier's perspective)
 - Distributor may have a higher incentive to allocate resources toward development of sales and marketing

- Disadvantages (Supplier's perspective)
 - Eliminating intra-brand competition through an exclusivity may give distributor too much comfort to intensify sales
 - Can lead to loss of control and flexibility
 - May lead to problems in M&A transactions of supplier's business

- Consequence (Supplier's perspective):
 - If sole/exclusive contracts are entered into, additional contractual measures must be taken:
 - Clear sales targets and right to terminate exclusivity if these are not met
 - Non-compete obligation of distributor
 - No long term contracts
 - Clear definition, what is exclusive (territory, products, sale channels)

Exclusivity III: Antitrust considerations

- Supplier may have an interest to keep territorial markets separate and therefore to prevent sales into other territories (e.g. because of price differences).
- Important: Check antitrust compliance of respective clauses
- EC/Swiss antitrust regulations
 - Supplier may only prevent distributor from actively promoting sales into territories reserved exclusively for himself or other distributors
 - Passive sales must remain allowed
 - Distributor cannot be prevented from selling in territories which have not been granted to others on an exclusive basis
- US antitrust regulations: Similar regulations, Federal and state law must be checked

Antitrust considerations: Other «Red-flag» provisions

- **Price fixing:** Distributor must remain free to fix the minimal resale price of a product.
- **Parallel trade:**
 - Prohibition to passively sell to customers outside the territory if distributor knows that the customer intends to resell the products back into the territory
 - Limitation of sales among distributors of a selective network
 - Restriction in selling spare parts to third parties
- **Non-compete obligation of distributor:** Non-competition clause shall not last for more than 5 years and not exceed one year after termination.
 - As the clause is essential for the contract, term of contract shall be limited to 5 years (no automatic renewal)

SUPPLY & DELIVERY

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Supply and Delivery of Goods

The difficulty in cross border agreements :

Due to the geographical distance between the parties simultaneous transfer of the goods sold and the consideration to be paid, is nearly impossible.

Such difficulty creates **two main problematic issues** when defining the supply and delivery terms and conditions:

- **Securing the consideration to be paid.**
- **Division of liabilities and responsibilities concerned with the physical transfer of the goods.**

What are the solutions?

Suggested Solutions:

Customary International Rules:

- A solution for the first issue (securing the consideration to be paid) - **International methods of payment.**
- A solution for the second issue (division of liabilities and responsibilities) - **Incoterms** (international commercial terms).

International Methods of Payment

Customary international methods of payment are, *inter alia*:

- Cash against documents (CAD)
- Cash on delivery (COD)
- Letters of credit (L/C)

Considerations to take into account when determining the preferable method of payment:

- The nature of the transaction.
- The type of the goods.
- The level of trust between the parties.
- The possible scenarios in the event that the purchaser does not transfer the consideration to be paid.

Incoterms

These rules resolve three main issues which relate to the relationship between the parties with respect to the transfer of the goods:

1. Who will be responsible for performing the necessary activities involving the supply and delivery of the goods from one country to the other?
2. Who will be responsible for the payment of such activities?
3. When does the risk to loss is shifted from one party to the other?

INDEMNIFICATION

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Indemnification I: Liability

- “Supplier shall indemnify and hold harmless distributor from and against any loss, expense... etc.”
- **Interest of supplier:** Supplier does want to limit its liability for the products with regard to amount and time.
 - **Interest of distributor:** Distributor wants supplier to be responsible for its actions or omissions given that the product is simply “conduit” for supplier’s product to ultimate customer

Indemnification II: Liability

- **Possible solution:** Apportionment of risk
 - Supplier responsible for IP indemnity
 - Each party responsible for its own actions re personal injury or property damage (usually manufacturer re product defect)
 - Each party responsible to indemnify the other re third party claims (usually manufacturer re product defect). Indemnification is conditioned upon certain criteria, e.g.
 - immediate notice of claim,
 - cooperation and support of other party in defense,
 - Indemnifier should control proceedings against third party
 - Financial cap of liability of each party
 - Exclusion or cap of consequential damages
 - Insurance solutions
 - Clear dispute resolution mechanism

Indemnification III: Customer compensation after termination

- A long term distributor may create substantial goodwill for a brand / product from which a supplier may profit also after expiration of a distribution agreement.
 - In most distribution agreements , the entitlement of the distributor to an indemnity for goodwill is explicitly excluded.

- **Problem:**
 - In some European jurisdiction (e.g. France, Spain, Belgium, Germany, Switzerland), such exclusion may be contrary to mandatory law.

- **Possible solution:**
 - Assessment of risk (may substantial goodwill be created by distributor?)
 - Reduction of risk (e.g. no access of supplier to customer list,)
 - Choice of law:
 - Is an exclusion contrary to mandatory provision of the applicable law?
 - Is a choice of law contrary to mandatory provision of the laws of the jurisdiction of the distributor?
 - Is a definition of the quantification mechanism for an indemnity payment recommendable?

TERMINATION

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Contract Termination: Overview

- *"There is an end to everything, to good things as well."* ~ Chaucer 1374
- **Termination Considerations must be evaluated early and often**
 - Termination depends on the circumstances.
 - Can range from a run of the mill occurrence to a positive event to a crippling event depending on circumstances
- **Different Impacts depending on Client Issues :**
 - Supplier Perspectives
 - Distributor Perspectives
 - The pay-out considerations
 - Considerations regarding duration issues
- **Want to avoid need for litigation and costly break-up**

Contract Termination: Considerations

- With Cause / Without Cause
 - Issues to consider
 - Did the distribution contract eliminate vagaries regarding termination and post-termination obligations?
 - Mutual rights/single party rights
 - Do local laws impact considerations? (implied covenants or good faith requirements)

Contract Termination: Considerations

- Performance Standard Impact
 - How they were defined can impact termination considerations
 - Are there cure considerations?

- Other breaches of Specific Clauses
 - Impact

- Does termination implicate antitrust issues?
 - Differences between distributors
 - Price issues

- Spell out specific issues in advance / consider including intent

- Notice Issues
 - Awareness of local laws or jurisdictional bias
 - Mutual Assent circumstance

Contract Termination: Considerations

- Common Additional Termination Criteria
 - Ownership and Control Issues
 - Financial Stability
 - Violation of statutory elements; i.e., U.S. Foreign Corrupt Practices Act

- Post-Termination Considerations
 - Non-compete
 - Return of product / Excess inventory
 - Post-termination obligations
 - Monies owed, ensuring rights maintained

JURISDICTION

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Resolution of Disputes and Jurisdiction

There are two issues involved:

1. Choosing the applicable law.
2. Choosing the venue of the dispute.

The difficulty in choosing:

1. A psychological and cultural difficulty.
2. A difficulty of predicting future scenarios.

What troubles us?

- ❖ Will the courts in a different jurisdiction treat me (the foreigner) equitably?
- ❖ What are the costs of litigating in a different jurisdiction?
- ❖ Does the foreign law provide me with the same protection I am getting from my own law which I am well familiar with ?

Tough questions, so what do we do?

Example of Suggested Solutions:

- ❑ Using a neutral venue and a neutral law system.
- ❑ Stipulating that the plaintiff will follow the defendant.
- ❑ A "mini dispute" resolution mechanism.

Summary - Practice and Tactics

Considerations to be taken into account:

- ✓ Convenience.
- ✓ Cost - Benefit.
- ✓ Tactical Considerations.
- ✓ Fairness.

There is no text book solution

Be creative (!)

Try and find a solution which will minimize the risk of a dispute.



Thank You!

Thank You For Participating

- Questions?
- For more information about Primerus and our presenters visit www.Primerus.com
- Today's presentation will be distributed to all participants in pdf format