PANORAMIC

DISTRIBUTION & AGENCY 2024

Contributing Editor

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LEXOLOGY

Distribution & Agency 2024

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Quick reference guide enabling side-by-side comparison of local insights, including into ownership structure and tax considerations for foreign suppliers in a direct distribution model; models involving local distributors, commercial agents and other representatives, including the general framework, rights of contract termination, and the transfer of rights of ownership; regulation of distribution relationships, including issues such as confidentiality, distribution of competing products, pricing, online sales and parallel imports; governing law and dispute resolution mechanisms; and recent trends.

Generated on: March 8, 2024

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Global overview

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In 2020, when the covid-19 pandemic hit, the world learned the importance of supply chains, and the impact on world commerce and on the ability to obtain everyday necessities when supply chains failed. Supply chains are the circulatory system of global trade. The relationships between manufacturers and suppliers, on the one hand, and their importers, distributors and commercial agents around the world, on the other, and then with their downstream retailers, form the critical links of these supply chains.

These relationships are critical to moving goods and services around the world, and they are governed not only by the contracts negotiated between suppliers and their distribution partners, but also by a diverse range of laws and regulations governing those contracts and relationships. These laws vary widely from country to country, and even within countries. Rapidly moving developments in areas such as privacy and data protection, and increasing concerns over cybersecurity, affect distribution relationships as well because of the importance of customer information and other data that is routinely shared between distribution partners.

The pandemic brought with it not only supply chain issues, but a sudden leap forward in the scope and use of e-commerce by consumers. At the same time, consolidation by mergers and acquisitions at all levels of the supply chain has created larger suppliers, distributors and retailers in industry after industry. These changes bring with them new forms of relationships among suppliers, distributors, and retailers created to meet developing needs of businesses and consumers, and raise a host of legal questions with different answers in each jurisdiction.

The options for a business seeking to bring its products or services to another market cover a spectrum of possibilities, from direct distribution by the supplier itself or through a wholly owned subsidiary; to engagement of a local commercial agent that does not take title to the goods, arranges sales on behalf of the supplier and receives a commission; to independent distributors, which buy from the supplier and resell in the market country at a profit; to franchising, which amounts to the use of independent distributors that are licensed to use the supplier's trademarks, required to follow a prescribed marketing plan or method of operation, and pay a fee to the supplier. All these options may be implemented through a joint venture by having the local distribution entity owned in part by the supplier, or by sharing the revenues and expenses in another manner. Yet another option is for the supplier to license a manufacturer in the market country to use its intellectual property – patent, copyright, trademark or trade secrets – to make its products locally and sell them. And private label arrangements amount to a reverse licensing arrangement, where a distributor or retailer in the market country distributes the supplier's products under its own trademark.

These options carry different costs, levels of control and sharing of revenues and expenses. They carry different legal and business risks, tax consequences and potential liability. Guiding clients through these options requires the effective distribution lawyer to understand each client's objectives, culture and ways of doing business, as well as industry

customs and practices, and then to apply the legal and regulatory environment of each relevant jurisdiction to help the client find the most effective and least risky method, among the many alternatives, of bringing its goods or services to market.

The growing role of e-commerce, the borderless nature of which inherently disrespects distribution territories, complicates the achievement of the objectives of distribution partners, especially if goods are distributed by the behemoth e-commerce intermediaries. Such e-commerce distribution makes the protection of distributor territories more difficult and thereby weakens distributor incentives to incur the expense of providing promotional, educational, warranty, quality control and merchandising services for products whose sales revenue may go elsewhere. Indeed, it may become entirely unfeasible for distributors to provide these services without some economic adjustments. Counsel must help their clients find ways to compensate for lost sales and restore appropriate incentives without running afoul of competition laws and other regulatory obstacles.

The practice of distribution law is necessarily interdisciplinary, because assisting clients in structuring and managing distribution relationships requires an understanding of each relevant jurisdiction's contract law; antitrust and competition law; dealer protection and business franchise law; privacy and data protection laws; consumer protection laws; advertising and unfair competition regulation; intellectual property law; international trade law; mergers and acquisitions law; and litigation, arbitration and dispute resolution.

By way of example, some nations provide for an indemnity payment to commercial agents upon termination without good cause, but not to distributors, while other countries cover distributors. The United States generally has no such provision – except for some states' business franchise laws and laws governing certain industries – yet Puerto Rico, a US territory, has one of the most stringent laws in the world protecting distributors against termination.

The collection and transfer of consumer data is tightly regulated in Europe, Canada and many other countries. For example, firms around the world must comply with the EU General Data Protection Regulation (GDPR) if they collect or process the personal information of individuals in Europe. Except for certain industries and types of data (eg, financial firms, children's data and medical information), the United States, at least on a national level, adopts a much more laissez-faire approach, which has led individual states to adopt differing and sometimes inconsistent laws, making compliance rather challenging.

Increased cybersecurity concerns have led to increased regulation at both national and state levels, imposing security standards and breach notification requirements on businesses. Where applicable, businesses must ensure that those with whom they share protected data comply with these requirements as well. This means that distribution and agency agreements need to address these issues.

Supplier control of resale prices is generally illegal in Europe, as are prohibitions on sales by distributors over the internet or outside defined territories, but in the United States all are typically permitted, with some exceptions. In most jurisdictions the licensing of intellectual property such as trademarks between suppliers and their distribution partners is a matter of private contract. However, some jurisdictions, such as Mexico, require trademark licences to be publicly filed. Even within a jurisdiction, different industries have different customs and practices that have a practical effect on how distribution relationships are structured. In the United States, for example, beer distributors share detailed data on their sales to customers

with their suppliers on a monthly – and often daily – basis, but soft drink bottlers and distributors zealously guard such customer sales data and generally will not share them. These legal and practical differences can have a major impact on how suppliers and their distribution partners do business, and counsel cannot possibly give sound advice without an understanding of these major differences in the regulatory framework and industry practices around the world.

Although *Panoramic: Distribution & Agency* will not make you an expert in all the relevant laws of every jurisdiction, it should provide a useful reference for the key issues in many important jurisdictions. It will still be important to engage qualified local counsel with expertise in the many facets of law affecting distribution before embarking on distribution in a new market or changing the manner of distribution in an existing one. However, this reference should enable you to better understand the issues and the questions to ask.

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Austria

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DORDA

Summary

GOVERNING LAW AND CHOICE OF FORUM

UPDATE AND TRENDS

DIRECT DISTRIBUTION

Ownership structures

1 | May a foreign supplier establish its own entity to import and distribute its products in your jurisdiction?

Yes, a foreign supplier may establish its own entity to import and distribute its products in Austria. However, the new entity will have to apply for a trade licence at the competent trade authority. In the case of the distribution of weapons, pyrotechnical products, and medical and medicinal products (regimented commercial trade), a specific certificate of qualification is required. Other restrictions might apply for the distribution of tobacco products.

Law stated - 1 February 2024

2 | May a foreign supplier be a partial owner with a local company of the importer of its products?

Generally, a foreign supplier may be a partial owner with a local company of the importer of its products. Only in some business sectors are foreign suppliers restricted from owning parts of the respective companies.

Law stated - 1 February 2024

3 | What types of business entities are best suited for an importer owned by a foreign supplier? How are they formed? What laws govern them?

Among the various corporate legal forms, the GmbH (a company with limited liability) is usually the best-suited type of entity for a foreign supplier that plans on establishing a local importing company. As its own legal entity, the GmbH's share capital must be formed by shareholder contributions and amount to at least €35,000, whereby half must be made in cash (as opposed to contributions in kind). Newly founded GmbHs can profit from the Founding Privilege. This entails that the articles of association can foresee that the share capital shall be limited to €10,000, whereby only half must be paid in cash up front. The privilege elapses after a period of 10 years, starting with the day of entry in the Companies Register. A GmbH is governed by the law of the same name: the GmbH-Gesetz (GmbHG).

Law stated - 1 February 2024

Restrictions

4 | Does your jurisdiction restrict foreign businesses from operating in the jurisdiction, or limit foreign investment in or ownership of domestic business entities?

Austrian law generally does not restrict foreign ownership. By way of exception, direct or indirect investment in Austrian companies by acquirers from outside the European

Economic Area and Switzerland may be subject to approval by the Austrian Minister of Economic Affairs under the Investment Control Act. The approval requirement applies to acquisitions of voting rights above a minimum threshold (above 10 per cent or 25 per cent, depending on the sector) in or control over companies that are active in critical infrastructure, critical technology or the supply of critical resources, as well as transactions that may have an impact on media plurality and access to sensitive data.

Law stated - 1 February 2024

Equity interests

5 May the foreign supplier own an equity interest in the local entity that distributes its products?

Yes, a foreign supplier may also own an equity interest in the local entity that distributes its products. However, he or she must also abide by the capital preservation principle and the rules derived therefrom. For instance, section 82(1) GmbHG determines that shareholders of a GmbH cannot reclaim their capital contributions. As long as the company exists, shareholders are only entitled to the duly determined dividends, insofar as these are in fact distributable. All transactions between a shareholder and his or her company must withstand comparison to a transaction made between the company and a third party (arm's-length principle).

Law stated - 1 February 2024

Tax considerations

6 What are the tax considerations for foreign suppliers and for the formation of an importer owned by a foreign supplier? What taxes are applicable to foreign businesses and individuals that operate in your jurisdiction or own interests in local businesses?

If the foreign supplier operates through an Austrian corporation (ie, GmbH), the Austrian entity itself is subject to corporate income tax of currently 25 per cent. Losses carried forward may be deducted (especially in the case of corporations such as GmbHs and stock corporations); however, they are limited to the extent of 75 per cent of the total amount of income. The remaining amount is not lost, but is retained as a loss carryforward for future years. Corporations are obliged to pay a minimum corporate income tax of 5 per cent of the share capital (ie, at least €1,750 for GmbHs) (there is a further reduced amount for the first 10 years after foundation – Founding Privilege). Capital gains tax of 27.5 per cent must be withheld from the profit distribution to the shareholders. However, under certain circumstances (eg, Parent-Subsidiary-Directive), no capital gains tax need be withheld. Double taxation treaties must be considered.

If the business is run by an individual, the personal income tax rate is up to 55 per cent (progressive tax rate).

There is no trade tax, but there is value added tax, which is in line with the VAT Directive of the EU. Income tax of employees must be withheld by the employer and wages are also subject to further side costs. Also, social security contributions for the employees fall due and are partly paid by the employer.

Law stated - 1 February 2024

LOCAL DISTRIBUTORS AND COMMERCIAL AGENTS

Distribution relationships

7 | What alternative distribution relationships are available to a supplier?

In general, Austrian law is based on the principle of contractual freedom. Therefore, any kind of alternative distribution relationship can be contractually agreed upon, insofar as this remains within the boundaries of lawfulness and morality.

Law stated - 1 February 2024

Legislation and regulators

8 | What laws and government agencies regulate the relationship between a supplier and its distributor, agent or other representative? Are there industry self-regulatory constraints or other restrictions that may govern the distribution relationship?

In Austria, commercial agency contracts are governed by the Austrian Act on Commercial Agents (HVertrG), which implemented European Council Directive 86/653/EEC into Austrian law. The HVertrG contains all special regulations on agents, some of which are mandatory, as provided for in the Directive. For issues that are not regulated by the HVertrG, the Austrian Civil Code (ABGB) and the Austrian Business Code (UGB) are applied.

Other alternative distribution relationships that are regulated by law are the ones between a supplier and a commercial broker (regulated in the Austrian Act on Brokers) and between a supplier and commissionaire (regulated in sections 383 to 405 UGB).

Apart from these, there are no specific acts or sets of legal rules on other alternative distribution relationships.

However, despite the fact that the Council Directive 86/653/EEC and the HVertrG only address commercial agents, Austrian case law considers some of the rules on commercial agents as analogously applicable also to distribution, franchise and other similar relationships if certain requirements are met. This in particular relates to section 24 HVertrG on termination indemnity.

Distribution relationships are also subject to restrictions under EU and Austrian antitrust law. The general rules applicable to vertical agreements in the EU (in particular the Vertical Block Exemption Regulation (EU) 2022/720) also apply in Austria. In addition, Austrian antitrust law provides for certain stricter rules for firms that hold a relative dominant position

vis-à-vis their business partners. These stricter rules can apply, in particular, in situations where a distributor is dependent on its supplier.

Law stated - 1 February 2024

Contract termination

9 Are there any restrictions on a supplier's right to terminate a distribution relationship without cause if permitted by contract? Is any specific cause required to terminate a distribution relationship? Do the answers differ for a decision not to renew the distribution relationship when the contract term expires?

Austrian law requires certain minimum notice periods for terminating a commercial agency contract for convenience. These increase from a one-month notice period within the first contract year up to a six-month notice period as of the beginning of the sixth contract year. These provisions are mandatory under Austrian law to the benefit of the agent. Hence, any differing contractual notice periods to the detriment of the agent are invalid and a contract termination based on shorter notice periods could entitle the agent to damages.

In contrast to commercial agents, Austrian statutory law does not provide for mandatory notice periods for distributors and other alternative distribution partners, although an analogous application of the termination provisions applicable to commercial agents could under certain circumstances be possible.

The Austrian Supreme Court (OGH) has rendered two decisions in connection with minimum notice periods for distribution agreements. Both cases concerned distribution agreements with car distributors. In a decision from 1997 (9 Ob 2065/96h), the OGH ruled that a notice period of only three months was grossly disadvantageous to the distributor and therefore immoral and invalid pursuant to section 879 ABGB. In a decision from 2000 (4 Ob 62/00x), the OGH pointed out that a one-year notice period could only be effectively agreed if the distributor was at the same time granted compensation for the investments it had made. Considering that Austrian law since 2004 provides for investment compensation claims for distributors (and other alternative distribution partners as well as agents) and in line with legal writing, a notice period of one year should be considered as a minimum notice period for most long-term distribution agreements.

Law stated - 1 February 2024

10 Is any mandatory compensation or indemnity required to be paid in the event of a termination without cause or otherwise?

Section 24 HVertrG, which under certain conditions applies analogously to other distribution partners, grants commercial agents termination indemnity in the amount of up to a year's earnings upon termination of their contract, if the following requirements are met:

- the agent has supplied the principal with new customers or has significantly expanded existing business relationships;

- it is to be expected that the principal or his or her successors will be able to draw considerable benefits from these business relationships even after termination of the contractual relationship; and
- the indemnity payment is to be considered equitable, in particular with regard to commissions the agent is going to lose from commercial transactions with such customers.

The calculation of such a claim is rather complex. In a nutshell, the total amount of termination indemnity may not exceed a figure equivalent to one year's average annual earnings calculated from the preceding five years (reduced accordingly, if less than five years).

However, a termination indemnity claim does not arise if the agent terminated the contract without any reason attributable to the principal or the principal terminated because of an important reason based on fault on the agent's side.

The requirements for an analogous application of section 24 HVertrG are an agent-like integration of the distribution partner into the sales organisation of the manufacturer and the transfer of the customer base to the manufacturer. It will usually be necessary to conduct a detailed assessment of the wording of the respective contract and its actual implementation by the parties to determine whether the requirements for such analogous application are met.

Section 454 Austrian Business Code provides agents and other distribution partners, in certain circumstances, with a compensation claim for investments they were required to make, but that are not amortised or of any further use at the time of termination of the contractual relationship. The term 'investment' is interpreted broadly so that also training or employing additional sales personnel could be regarded as such. The compensation amount is calculated by deducting the amortisation from the respective investments made by the agent or distribution partner.

The right to termination indemnity and to investment compensation is mandatory law and may not be amended to the detriment of the distribution partner.

Law stated - 1 February 2024

Transfer of rights or ownership

11 Will your jurisdiction enforce a distribution contract provision prohibiting or restricting the transfer of the distribution rights to the supplier's products, all or part of the ownership of the distributor or agent, or the distributor or agent's business to a third party?

In general, Austrian law permits contractual provisions that aim to prohibit or restrict the transfer of distribution rights, of ownership of the distributor or of his or her or an agent's business to a third party. For instance, parties can agree to include a change-of-control-clause, which would give one of them certain rights (consent, termination) in connection to a change of the other party's ownership structure.

Law stated - 1 February 2024

REGULATION OF THE DISTRIBUTION RELATIONSHIP

Confidentiality agreements

12 Are there limitations on the extent to which your jurisdiction will enforce confidentiality provisions in distribution agreements?

Generally, no. However, with regard to the post-contractual effects of confidentiality agreements, some limitations may arise in particular from section 1 of the Unfair Trade Practices Act to the benefit of agents concerning the use of customer details.

Law stated - 1 February 2024

Competing products

13 Are restrictions on the distribution of competing products in distribution agreements enforceable, either during the term of the relationship or afterwards?

Non-compete obligations are binding and enforceable provided that they comply with antitrust law. Business conduct in Austria is subject to EU antitrust law, namely articles 101 and 102 of the Treaty on the Functioning of the European Union and secondary legislation, as well as to Austrian antitrust law, the substantive provisions of which are laid down in the Austrian Cartel Act 2005 (KartG). Of particular relevance to distribution agreements is Commission Regulation (EU) 2022/720 (VBER), which provides for block exemption of vertical agreements provided that certain conditions are met. Further safe harbour is provided by the de minimis exemption, as laid down in the European Commission's De Minimis Notice of 2014 and its national equivalent, section 2(2)(1) KartG.

The de minimis exemption exempts non-compete clauses in distribution agreements irrespective of their duration, provided that both parties do not hold a market share exceeding 15 per cent and the agreement does not contain other provisions that are deemed to restrict competition by object (in particular, resale price maintenance).

If the parties hold market shares of between 15 and 30 per cent, non-compete agreements will benefit from exemption under the VBER if their duration is limited to five years. Non-compete clauses which provide for tacit renewal may benefit from the exemption if the buyer can effectively renegotiate or terminate the agreement after five years with a reasonable period of notice and at a reasonable cost. Moreover, the five-year limit does not apply if the contract goods are sold by the distributor from premises owned by the supplier or leased by the supplier from a third party.

Post-contractual non-compete provisions generally are not exempted. By way of exception, a one-year post-contractual non-compete is exempted if it is indispensable to protect know-how provided by the supplier to the distributor, and limited to premises from which the distributor has operated during the contract period and to goods that compete with the contract goods or services.

Austrian law provides for a very low presumption of market dominance, which kicks in at a market share of 30 per cent. Non-compete agreements entered into by dominant undertakings are prohibited, unless they are not capable of foreclosing as efficient competitors (ECJ Case C-413/14 P *Intel*) or justified by efficiencies. While the presumption of dominance is rebuttable, non-compete agreements entered into by firms that hold a market share of more than 30 per cent therefore require a careful case-by-case analysis.

In certain distribution relationships, non-compete provisions may be justified for an unlimited period of time if they are strictly necessary for the operation of the distribution system. This justification may, in particular, apply to franchise agreements (ECJ Case 161/84 *Pronuptia*) and agency agreements.

Law stated - 1 February 2024

Prices

14 May a supplier control the prices at which its distribution partner resells its products? If not, how are these restrictions enforced?

The imposition of fixed or minimum resale prices (resale price maintenance, RPM) constitutes a hardcore restriction of EU and Austrian antitrust law. Infringements are subject to a fine of up to 10 per cent of consolidated turnover (although most fines are lower in practice). The Austrian Federal Competition Authority (FCA) has been very active in enforcing the prohibition of RPM, in particular in the food and beverages and consumer electronics sectors. Since 2012, approximately 50 firms have been fined for RPM. In addition to substantial fines, violations of the prohibition of RPM will also be deemed void and unenforceable.

The prohibition of RPM does not apply in genuine agency relationships. Limited exceptions also exist in other distribution relationships, in particular to coordinate short-term price campaigns in uniform distribution systems. For RPM that is not limited to such specific circumstances, while recent ECJ case law (Case C-211/22 *Super Bock*) opens up arguments for the justification of RPM in individual cases, the Austrian courts have historically not been receptive to arguments that RPM may be necessary to prevent free riding.

Law stated - 1 February 2024

15 May a supplier influence resale prices in other ways, such as suggesting resale prices, establishing a minimum advertised price policy, announcing it will not deal with customers who do not follow its pricing policy, or otherwise?

While RPM constitutes a hardcore restriction of EU and Austrian antitrust law, suppliers may recommend resale prices or establish a maximum resale price. Maximum or recommended resale prices will, however, be prohibited if they amount to RPM as a result of pressure applied or incentives granted by either party. Moreover, recommended prices must be explicitly designated as non-binding under Austrian law (section 1(4) KartG).

The imposition of minimum advertised prices (MAPs) is generally treated as indirect RPM and thus illegal. MAPs may, however, be in line with EU and Austrian competition law if they are merely recommended by the supplier, without any pressure applied or incentives granted to ensure compliance.

Law stated - 1 February 2024

16 May a distribution contract specify that the supplier's price to the distributor will be no higher than its lowest price to other customers?

Most favoured customer clauses are exempted under the VBER provided that the 30 per cent market share threshold is not exceeded. By way of exception, Across Platform Parity clauses, which cause a seller on an online platform not to sell under more favourable conditions via competing online platforms, do not benefit from exemption under the VBER.

Above 30 per cent market share, such clauses are only in line with EU and Austrian antitrust law if they either are not capable of foreclosing as efficient competitors or are justified by efficiencies.

Law stated - 1 February 2024

17 Are there restrictions on a seller's ability to charge different prices to different customers, based on location, type of customer, quantities purchased, or otherwise?

Under Austrian antitrust law, firms that hold a dominant position (including a relative dominant position vis-à-vis their business partners) may not apply dissimilar conditions to equivalent transactions, unless there is an objective justification to do so. Infringements of the antitrust prohibition of discrimination may be subject to fines, but have generally not been a major enforcement focus.

In addition, the Austrian Act on Local Supplies provides for a general duty of non-discrimination in distribution relationships. Infringements of this prohibition are not subject to fines but may be enforced in the courts by means of cease-and-desist orders.

Law stated - 1 February 2024

Geographic and customer restrictions

18 May a supplier restrict the geographic areas or categories of customers to which its distribution partner resells? Are exclusive territories permitted? Is there a distinction between active sales efforts and passive sales that are not actively solicited, and how are those terms defined?

Restrictions of the territory or customers that the distributor may sell to are subject to strict limits under EU and Austrian antitrust law. Pursuant to article 4 VBER, territory or customer restrictions will generally be considered as hardcore restrictions. By way of exception, suppliers may restrict:

- active sales into exclusive territories or to exclusive customer groups reserved to the supplier or up to five other distributors;
- sales to end customers by distributors operating at the wholesale level;
- sales to unauthorised dealers by members of a selective distribution system; and
- sales of components sold to the distributor for purposes of incorporation to manufacturers that would use them to produce competing goods.

'Active sales' means sales solicited by the distributor by approaching individual customers (eg, by way of direct mail, unsolicited emails, visits or advertising targeting a specific territory or customer group). Passive sales are sales made in response to unsolicited requests from customers. General advertising that is not targeted at a specific territory or customer group is considered passive selling.

Geographic or customer restrictions that do not meet the above criteria may in exceptional cases be in line with EU and Austrian antitrust law if they meet the criteria of the efficiency defence (article 101(3) TFEU, section 2(1) KartG).

Law stated - 1 February 2024

19 | If geographic and customer restrictions are prohibited, how is this enforced?

Geographic or customer restrictions that do not conform to the requirements of antitrust law are subject to fines of up to 10 per cent of consolidated turnover. While public enforcement by competition authorities is not as frequent as against RPM, fines have nonetheless been imposed in a number of cases (eg, in the European Commission's *Guess*, *Nike (ancillary sports merchandising)*, *Pioneer* and *PC video games* cases).

In addition, restrictions that infringe antitrust law are void. Distributors can either enforce this voidness by civil cease-and-desist actions, or defend against claims by the supplier by relying on the voidness of the restriction.

Law stated - 1 February 2024

Online sales

20 | May a supplier restrict or prohibit e-commerce sales by its distribution partners?

Under EU and Austrian antitrust laws, clauses prohibiting online sales by distribution partners constitute 'by object' restrictions of competition. They constitute hardcore restrictions pursuant to article 4(e) VBER and are deemed to restrict without there being a need to prove anticompetitive effects (ECJ Case C-439/09 *Pierre Fabre*). While total internet bans may be justified if they meet the criteria of the efficiency defence of article 101(3) TFEU and section 2(1) KartG, this is in fact very unlikely.

By contrast, restrictions that fall short of a total ban will not necessarily infringe antitrust law. In particular, clauses that prohibit the use of third-party platforms for online sales do not constitute hardcore restrictions under the VBER, and will thus benefit from exemption if the

parties do not exceed the 30 per cent market share threshold. If the market share threshold is exceeded, such clauses may nonetheless comply with EU and Austrian antitrust law if the clause is necessary in view, for example, of the luxury character of the products); it is laid down and applied without discrimination; and it is proportionate in the light of the objective pursued (ECJ Case C-230/16 *Coty Germany*).

Restrictions of online sales to customers located outside of the distributor's assigned territory are subject to the general rules for territorial restrictions. Suppliers may therefore only prohibit active sales to territories that have been exclusively reserved to the supplier or another distributor. The operation of a website through which customers, including such from outside the territory, may initiate sales, constitutes an act of passive selling that may not be restricted. A requirement that distributors reroute traffic from outside their territory to the supplier or the local distributor therefore constitutes a hardcore restriction of antitrust law. The blocking of access to online interfaces based on nationality or place of residence also runs afoul of the EU's Geo-Blocking Regulation (Regulation (EU) 2018/302). By contrast, the targeting by outside distributors of customers in exclusively assigned territories (eg, by setting up a website in a language that is not commonly used in their own territory or by territory-based banners) constitutes active selling, which the supplier may prohibit.

'Invasion fees' to be paid by a distributor to another in the case of sales to the latter's exclusive territory are difficult to reconcile with EU antitrust law. By way of exception, such clauses may withstand scrutiny if they are limited to a realistic assessment of the cost of the after-sales services that will have to be provided by the local distributor, increased by a reasonable profit margin (European Court of First Instance, Case T-67/01 *JCB Service*).

Law stated - 1 February 2024

21 May a distributor or agent restrict a supplier's sales through e-commerce intermediaries into the distribution partner's territory? May it require the supplier to obtain reports of such sales by territory and a payment of 'invasion fees' or similar amounts to the distribution partner?

Restrictions on the supplier's own sales are exempted under the VBER if the 30 per cent market share threshold is not exceeded. As regards sales by the supplier's other third-party intermediaries, only active sales to territories that have been exclusively reserved to the supplier or another distributor may be restricted.

Law stated - 1 February 2024

Refusal to deal

22 Under what circumstances may a supplier refuse to deal with particular customers? May a supplier restrict its distributor's ability to deal with particular customers?

As an expression of their freedom of contract, suppliers may generally refuse to deal with customers. Dominant suppliers may be subject to an obligation to deal under antitrust law unless a refusal is objectively justified (eg, due to lack of spare capacity or due to the

customer not being suitable). By contrast, customer restrictions imposed by the supplier on the distributor are subject to limits under antitrust law even if the supplier is not dominant.

Law stated - 1 February 2024

Competition concerns

23 Under what circumstances might a distribution or agency agreement be deemed a reportable transaction under merger control rules and require clearance by the competition authority? What standards would be used to evaluate such a transaction?

Distribution or agency agreements typically do not constitute reportable mergers. Exceptionally, a distribution agreement may lead to the supplier acquiring control over the distributor. Even in the case of franchise agreements, this, however, is generally not the case. The type of requirements typically established in franchise agreements, such as an obligation to source the franchise products from the franchisor and requirements regarding the presentation of the products and staffing, do not give rise to an acquisition of control within the meaning of Austrian merger control. A reportable merger may, however, exist if the supplier is granted veto rights regarding the appointment of the distributor's management, its budget or investments (Austrian Supreme Court 21.3.2007, 16 Ok 1/07). In addition, Austrian merger control also covers certain business lease agreements, under which the distributor takes over the operation of a site owned by the supplier.

Reportable mergers may be prohibited if they give rise to a significant impediment to effective competition, or create or strengthen a dominant position.

Law stated - 1 February 2024

24 Do your jurisdiction's antitrust or competition laws constrain the relationship between suppliers and their distribution partners in any other ways? How are any such laws enforced and by which agencies? Can private parties bring actions under antitrust or competition laws? What remedies are available?

Austrian antitrust law provides for stricter rules for firms that hold a relative dominant position vis-à-vis their business partners. A relative dominant position exists, in particular, if distributors are dependent on the maintenance of the business relationship with the supplier to avoid serious economic disadvantages. This may occur, in particular, in the case of exclusive dealers who cannot easily switch to other suppliers because their know-how is specific to the products of the manufacturer that they represent and their goodwill is closely tied to that of the manufacturer.

The application of the competition law in cases of relative dominance can lead to a stricter review of the fairness of clauses of the distribution agreement than is generally the case under Austrian law. The review comprises two stages. First, the courts examine whether the clause pursues a legitimate aim, and second, whether it is proportionate. Clauses that only or overwhelmingly are in the interest of the dominant supplier will be considered illegal. In a recent case involving exclusive car dealerships, the Austrian courts considered, for

example, an increase of the variable part of the dealer's commission to 40 per cent, as well as rules governing the remuneration for warranty works that were approximately 10 per cent below the dealer's real cost for such works, as abusive (Austrian Supreme Court 17.2.2021, 16 Ok 4/20d).

Competition law is enforced by the FCA, which has investigative powers but does not have decision-making powers. The decision-making stage in Austrian competition proceedings takes the form of court proceedings before the Cartel Court. Upon application by the FCA or the Federal Cartel Prosecutor, or both, the Cartel Court may order undertakings to bring an infringement to an end (and impose obligations that are necessary to that effect) and impose fines. Private parties may also bring proceedings for cease-and-desist orders before the Cartel Court, but may not request fines. In addition, competition law may also be relied on to support claims in the ordinary civil courts.

Law stated - 1 February 2024

Parallel imports

25 Are there ways in which a distributor or agent can prevent parallel or 'grey market' imports into its territory of the supplier's products?

Distributors and agents generally do not have direct claims against parallel or 'grey market' importers. A direct claim will only be sustained if the importer knowingly encouraged or otherwise actively contributed to the supplier's breach of contract, which is difficult to prove. Generally, distributors will, therefore, have to seek their supplier's support in preventing such imports. Suppliers may have a claim against the parallel importer if the imports infringe sales restrictions in the importer's own distribution agreement (provided that such restrictions are valid under competition law). Suppliers may also rely on trademark rights to prevent parallel imports. In the case of parallel imports within the EU, trademark claims, however, typically will not be upheld, since the trademark right is exhausted on an EU-wide basis once the trademarked goods are put on the EU market by the proprietor of the trademark or with his or her consent. Trademark claims may, however, exceptionally be sustained, even in the case of intra-EU imports, if the use by the importer seriously damages the reputation of the trademark.

Law stated - 1 February 2024

Advertising

26 What restrictions exist on the ability of a supplier or distributor to advertise and market the products it sells? May a supplier pass all or part of its cost of advertising on to its distribution partners or require them to share in its cost of advertising?

Restrictions may apply where the supplier holds a relative dominant position vis-à-vis the distributor. In a recent case, the pass-on of the costs of mystery shopping (to test customers' shopping experience when buying at the distributor) to the distributor was

held to amount to an abuse of the supplier's dominant position (Austrian Supreme Court 17.2.2021, 16 Ok 4/20d).

As a rule, obliging distributors to bear (part of) the advertising and promotion costs also rules out the qualification of the distribution relationship as a genuine agency agreement under competition law. Thus, the agency exemption will generally not apply to such agreements.

Also, an indirect restriction comes into play via section 454 Austrian Business Code (investment compensation), as advertising costs are considered to amount to investments that might have to be compensated for at the end of the contractual relationship.

Law stated - 1 February 2024

Intellectual property

27 How may a supplier safeguard its intellectual property from infringement by its distribution partners and by third parties? Are technology transfer agreements common?

Intellectual property may either be registered to ensure protection (ie, patents and trademarks) or is automatically protected (ie, works protected by copyright, trade secrets and know-how). In the case of trade secret protection, it is further necessary that the owner implement reasonable measures to ensure confidentiality. Therefore, the first step is to set up a well-thought-out intellectual property strategy and to implement the necessary steps.

In addition to the statutory safeguards, distribution agreements regularly contain detailed provisions on the use of the supplier's intellectual property rights. Such agreements usually try to strike a balance to grant as few rights as possible, but as many as are reasonably necessary. The goal should be that the supplier's intellectual property rights are protected against the distributor and third parties, but that the distribution partner is permitted to exploit the intellectual property in both parties' interests.

Technology transfer agreements do not play a significant role with regard to distribution and agency agreements.

Law stated - 1 February 2024

Consumer protection

28 What consumer protection laws are relevant to a supplier or distributor?

There are various consumer protection laws relevant for the sale of products under Austrian law, in particular the Austrian Consumer Protection Act (KSchG). However, as these provisions only apply to B2C relationships, they usually do not apply to agency contracts or contracts with other distribution partners. An exception to this rule exists in those cases in which the agent or other distribution partner is a natural person who has not started its agency or distribution business at the time of concluding the agency or distribution contract, so that the latter is only a preparatory agreement. Pursuant to section 1(1)(3) KSchG, such

preparatory agreements are considered as B2C contracts under Austrian law, so that, for example, certain clauses (such as limitations of liability or referrals of burden of proof) might not have been validly concluded.

Law stated - 1 February 2024

Product recalls

29 Briefly describe any legal requirements regarding recalls of distributed products. May the distribution agreement delineate which party is responsible for carrying out and bearing the cost of a recall?

The Austrian Product Security Act provides for certain obligations of producers and importers, including the obligation to recall products if necessary. Within the boundaries of lawfulness and morality, the responsibility for carrying out and bearing the costs of a recall may – inter partes – be shifted to the agent or other distribution partner.

Law stated - 1 February 2024

Warranties

30 To what extent may a supplier limit the warranties it provides to its distribution partners and to what extent can both limit the warranties provided to their downstream customers?

In B2B cases it is possible to limit the warranty under Austrian law. However, limitation of liability is invalid with regard to any wilful misconduct or crass gross negligence (ie, the highest degree of gross negligence) and potentially also regarding simple gross negligence. Furthermore, such limitation does not apply to claims under the Austrian Product Liability Act and bodily injuries.

The same applies to warranties provided to downstream customers unless the customer is a consumer. Towards consumers, any exclusion of the entrepreneur's liability for any kind of gross negligence as well as any restriction of warranty rights for new products is inadmissible.

Law stated - 1 February 2024

Data transfers

31 Are there restrictions on the exchange of information between a supplier and its distribution partners about the customers and end users of their products? Who owns such information and what data protection or privacy regulations are applicable?

Whether any additional restrictions or rules on the exchange of information on customers and end-users between a supplier and its distribution partners apply will depend on its

type and content: if no personal data is contained – thus, for aggregated or anonymised information only (eg, overall number of customers; aggregated turnover) – the exchange of information would usually be permitted, subject to any specific non-disclosure provisions in underlying contracts. As soon as personal data is covered, the General Data Protection Regulation (GDPR) as well as the Austrian Data Protection Act will apply.

Any transfer of personal data requires legal justification, which preliminarily depends on the relationship between the supplier and its distribution partner: If one of the parties is acting on behalf of and based on the instructions of the other party, a data processing agreement in line with article 28 GDPR is usually sufficient. However, as soon as both supplier and distribution partner intend to initially share and subsequently use personal data for their own purposes, article 6 (and article 9 for sensitive data) GDPR requires a specific legal ground. In practice, this is usually either the fulfilment of a contract with a customer or end-user or freely given consent. The latter is frequently required as soon as any direct marketing via electronic messages or phone shall be enabled pursuant to section 174 Austrian Telecommunication Act. Finally, if a supplier and its distribution partners jointly decide on the use of personal data, an additional joint controller agreement in line with article 26 GDPR is required (which leads to joint liability).

If either the supplier or any distribution partner is situated in a third country outside the EEA, additional restrictions apply: as long as no adequacy decision is in place (such as for the United Kingdom, Israel or Switzerland), sufficient guarantees need to be implemented to ensure adherence to GDPR principles. In practice, this is usually done via EU Standard Contractual Clauses. The concerns of the European Court of Justice in its ruling on the invalidity of the Privacy Shield (C-311/18, *Schrems II*) had and still continue to have a great impact on the market as it requires additional safeguards, mitigating measures and binding commitments to be implemented. In Austria, the focus in negotiations is on supplementary measures, which usually consist of factual limitations by ensuring encryption combined with supplementary contractual safeguards in line with the current market standard as well as EDPB Guidelines. Based on the outcome of agreed contractual and technical measures, each data exporter additionally needs to conduct and document a reliable transfer impact assessment.

Law stated - 1 February 2024

32 What requirements apply to suppliers and their distribution partners with respect to protecting the security of customer data they hold?

Article 32 GDPR provides for rather generic and technology-neutral security obligations, only. Thus, suppliers and distribution partners need to set up adequate technical and organisational measures to hinder any loss, alteration, unauthorised disclosure or misuse of personal data by taking into account the current state of the art, the sensitivity of data categories covered and the potential risks involved, as well as the costs of implementation. In addition, any established measures need to be continuously monitored as well as frequently developed to address the increasing risk of cyber incidents and attacks. This includes, inter alia, adequate training and awareness of supplier and distribution partner's employees as well as any sub-processors used. In the case of any data breach, special attention should be paid to the requirement of a notification to the competent Supervisory Authority within 72 hours upon appearance.

Law stated - 1 February 2024

Employment issues

33 May a supplier approve or reject the individuals who manage the distribution partner's business, or terminate the relationship if not satisfied with the management?

Without a specific contractual provision granting such a right, a supplier may not approve or reject personnel or managers of its distribution partner. Whether a supplier may terminate the relationship will depend on the circumstances of the case. A termination for convenience, which would usually solve the latter issue, is not permitted in fixed-term contracts unless explicitly provided for.

Law stated - 1 February 2024

34 Are there circumstances under which a distributor or agent, or its employees, would be treated as an employee of the supplier, and what are the consequences of such treatment? How can a supplier protect against responsibility for potential violations of labour and employment laws by its distribution partners?

Yes, the distributor or agent could be treated as an employee under certain circumstances, particularly if:

- it is bound by a certain working time and place of work;
- it is required to personally perform services for the supplier and cannot sub-contract such services;
- it uses operational equipment supplied or paid for by the supplier; or
- it is integrated into the supplier's business.

By way of example, this could mean that the distributor takes part in internal meetings, has its own support staff or has an email address with the supplier's domain.

The distinction between employees and contractors is subject to a case-by-case analysis and does not hinge on any one of the above criteria.

Unlike employees, self-employed individuals are not entitled to the usual minimum standards of employment, including minimum wages, working hour regulations and overtime compensation, holidays and sick leave. If distributors or agents are re-classified as employees, the supplier may, therefore, be required to pay certain benefits in retrospect.

The supplier would also be liable for the payment of social insurance contributions, wage tax and other levies for the distributor or agent in retrospect. The payment of social insurance contributions is usually the greatest risk and the suppliers will be unable to recover such contributions from the distributor or agent.

If, however, the distributor or agent holds his or her own trade licence, the supplier would not be required to pay social insurance contributions for him or her.

Law stated - 1 February 2024

Commission payments

35 | Is the payment of commission to a commercial agent regulated?

The parties are generally free to agree on the rate of commission. In the absence of another agreement, the amount of the commission depends on the normal rates of the respective business sector at the establishment of the commercial agent (see section 10 Austrian Act on Commercial Agents (HVertrG)).

Claims for commission payments become due with the legal effectiveness of the intermediated transaction between the principal and the third party, if and when the principal has carried out the business; the principal according to the contract with the third party would have to carry out the business; or the third party has completed the business by having provided its performance.

The claim for a commission is extinguished if and when it is established that the contract between the third party and the principal is not performed, and this non-performance is not based on circumstances that have to be borne by the principal.

Law stated - 1 February 2024

Good faith and fair dealing

36 | What good faith and fair dealing requirements apply to distribution relationships?

There are no specific good faith and fair dealing requirements for agency and distribution contracts under Austrian law. However, section 5 HVertrG stipulates that the agent must perform his or her duties in the interest of the principal with the diligence of an ordinary entrepreneur. The agent is in particular required to make the necessary notifications to the principal and inform him or her immediately of any business transaction that he or she has closed for him or her.

An outcome of the commercial agent's duty to look after the interests of his or her principal is the prohibition to act for a competitor of the principal. This prohibition, therefore, exists in principle even without an express contractual agreement.

Law stated - 1 February 2024

Registration of agreements

37 | Are there laws requiring that distribution agreements or intellectual property licence agreements be registered with or approved by any government agency?

There are no laws requiring distribution agreements to be registered or approved by a government agency. As regards licensing agreements, they do not need to be registered in the registry of the Austrian Patent Office, but they can be. It is usually beneficial for the licensee to do so, as the licence then stays valid even if a third party acquires ownership of the underlying intellectual property right.

Law stated - 1 February 2024

Anti-corruption rules

38 To what extent are anti-bribery or anti-corruption laws applicable to relationships between suppliers and their distribution partners?

Austrian criminal law distinguishes between corruption in the public and private sectors. Corruption in the private sector is regulated under section 309 of the Austrian Criminal Code (StGB) and includes the acceptance of gifts and bribery of suppliers, distribution partners and customers.

Section 309 StGB punishes employees or representatives of a company who, in the course of business transactions, demand or accept an advantage or accept the promise of an advantage, each for themselves or for a third person in return for the execution or omission of a legal act in breach of the person's duties, with imprisonment of up to five years (the sentence is depending on the value of the advantage).

The same applies to any person who offers, promises or provides a benefit to an employee or representative of a company in return for the execution or omission of a legal act in breach of that person's duties in the course of business transactions.

According to the Austrian Corporate Criminal Liability Act, organisations in Austria can – under certain circumstances – be held criminally responsible for the criminal offences of their employees and decision-makers. Therefore, not only the individual person but also the company may be liable to prosecution for violation of corruption laws.

Law stated - 1 February 2024

Prohibited and mandatory contractual provisions

39 Are there any other restrictions on provisions in distribution contracts or limitations on their enforceability? Are there any mandatory provisions? Are there any provisions that local law will deem included even if absent?

Austria is a civil law jurisdiction, so that contracts subject to Austrian law will usually be supplemented by statutory law on those points that were not provided for by the parties in their agreement.

The HVertrG contains several mandatory provisions (section 27 lists them). Some of them apply by analogy to other distribution partners if certain conditions are met.

Law stated - 1 February 2024

GOVERNING LAW AND CHOICE OF FORUM

Choice of law

40 Are there restrictions on the parties' contractual choice of a country's law to govern a distribution contract?

Generally, the parties are free to choose the law governing their agency or distribution contract. However, this is restricted by article 9 of the Rome I Regulation with regard to overriding mandatory provisions of the law of the forum (article 9 (2)) and to a certain extent also of the law of the country where the obligations arising out of the contract have to be or have been performed (article 9 (3)).

For example, section 24 Austrian Act on Commercial Agents (HVertrG) implemented article 17 (2) of European Council Directive 86/653/EEC into Austrian law and is mandatory under Austrian law. On the basis of the *Ingmar* decision of the European Court of Justice (C 381/98), section 24 HVertrG is considered to be an international mandatory provision within the meaning of article 9 of the Rome I Regulation vis-à-vis the law of a third country (ie, a non-member of the European Union). Thus, the agent's claim for indemnity cannot be waived or contracted out where the agent acts within the European Union. A choice of law outside the European Union would be superseded by section 24 HVertrG.

The prevailing majority of Austrian literature seems to agree that an extension of the termination indemnity provision for commercial agents to distributors is not an international mandatory provision. Hence, for distribution contracts there are valid legal arguments for the parties to be free to choose the applicable law without any restrictions.

With regard to investment compensation pursuant to section 454 Austrian Business Code, the prevailing majority seems to agree that this is an international mandatory provision (also towards other European Union jurisdictions), so that this obligation cannot be excluded by choosing a different applicable law, for agents as well as for other distribution partners.

Law stated - 1 February 2024

Choice of forum

41 Are there restrictions on the parties' contractual choice of courts or arbitration tribunals, whether within or outside your jurisdiction, to resolve contractual disputes?

If there is a risk that the law to be applied by the agreed courts or tribunals does not recognise the mandatory termination indemnity under section 24 HVertrG, jurisdiction agreements or arbitration clauses with a commercial agent predominantly active in the territory of the European Union, opting for courts outside the European Union might be considered inoperable by Austrian courts. Pursuant to recent case law (see, for example, the Austrian Supreme Court in 5 Ob 72/16y, as well as the German judgments of the Upper Regional Court Munich in 7 U 1781/06 and the German Supreme Court in VII ZR 25/12), such jurisdiction agreements are also held inoperable if the principal is domiciled outside

the European Union but the commercial agent has carried out his or her activities in a member state and the agreement provides for the application of non-European law and a place of jurisdiction outside the European Union.

Law stated - 1 February 2024

Litigation

42 What courts, procedures and remedies are available to suppliers and distribution partners to resolve disputes? Are foreign businesses restricted in their ability to make use of these courts and procedures? Can they expect fair treatment? To what extent can a litigant require disclosure of documents or testimony from an adverse party? What are the advantages and disadvantages to a foreign business of resolving disputes in your country's courts?

Foreign as well as national businesses can choose whether to resolve their disputes before a national court or an arbitral tribunal. In this year's Eurobarometer, Austria was ranked first in the category of 'perceived independence of courts and judges among the general public'. This extent of trust can be seen as a testimony to the practice of fair treatment that parties enjoy before Austrian courts.

Within very strict limits (see section 303 of the Austrian Code of Civil Procedure), an Austrian court may, upon a party's request, order the opponent to produce a specific document. However, this is much narrower than document production or disclosure in common law jurisdictions.

As regards potential disadvantages, foreign parties often find it restrictive that Austrian courts require all evidence to be translated into German, that plaintiffs from outside the EEA might be ordered to deposit a retainer for the procedural costs of the defendant and that Austrian court fees are comparatively high.

Law stated - 1 February 2024

Alternative dispute resolution

43 Will an agreement to mediate or arbitrate disputes be enforced in your jurisdiction? Are there any limitations on the terms of an agreement to arbitrate? What are the advantages and disadvantages for a foreign business of resolving disputes by arbitration in a dispute with a business partner in your country?

Yes, agreements to arbitrate or to mediate will be enforced in Austria. Austria is a party to the New York Convention and the Geneva Convention. With regard to agency or other distribution partners, there are no noteworthy limitations. Although in practice very seldom, proceedings on the setting aside of an arbitral award are dealt with by the Austrian Supreme Court directly. This single instance for setting aside claims further enhances the efficiency of arbitrations seated in Austria.

Law stated - 1 February 2024

UPDATE AND TRENDS

Key developments

44 Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? Are there any other current developments or trends that should be noted?

Sustainability requirements for supply agreements will likely give rise to increased compliance risks within the EU. Supply chain sustainability requirements have already been enacted in a number of member states, including France and Germany. While Austria has not introduced its own rules, the European Commission presented a proposal for a Directive on Corporate Sustainability Due Diligence on 22 February 2022. Following the presentation of the proposal by the European Commission, the European Parliament and the Council of the European Union began their work and reached a trilogue agreement in December 2023. The legislative process is expected to be completed in 2024. After that, Austria will have to adopt the Directive within two years.

Law stated - 1 February 2024

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Summary

GOVERNING LAW AND CHOICE OF FORUM

UPDATE AND TRENDS

DIRECT DISTRIBUTION

Ownership structures

1 | May a foreign supplier establish its own entity to import and distribute its products in your jurisdiction?

Yes, a foreign supplier may establish an affiliated Brazilian company to distribute its products in the territory. There are no predetermined conditions provided by local law for a foreign distributor to perform distribution activity directly, including restrictions on setting up an entity specifically to conduct distribution transactions, among others. Foreign companies may suffer restrictions, however, when participating directly in specific fields of activities.

Law stated - 6 February 2024

2 | May a foreign supplier be a partial owner with a local company of the importer of its products?

Yes, a foreign supplier may be a partial owner with a local company that imports the supplier's products. It may be a sole owner of a local company (affiliated company) too. Nevertheless, for the creation of a local company with a foreign shareholder, the company must have its headquarters in the territory and hold a Brazilian partner as a manager of the affiliate or appoint a local legal representative (which may be a partner with a small quantity of shares) duly empowered to receive any summons and act on the company's behalf before the Brazilian authorities.

Law stated - 6 February 2024

3 | What types of business entities are best suited for an importer owned by a foreign supplier? How are they formed? What laws govern them?

Among different types of corporate entities in Brazil, there are two outstanding forms for a foreign supplier to participate as a shareholder in a local importer. The first is the limited liability entity (*limitada*) and the second is the joint-stock company (*sociedade anônima*). These forms are relevant as they limit the shareholder's liability to the equity investment in case of bankruptcy or insolvency. A *limitada* is looked upon as similar to a limited-liability partnership or a 'closely held company' under American law and to a limited partnership under English law. The *limitada* is governed by Federal Law 10,426 of 10 January 2002 (the Civil Code). The *limitada* shall be created by means of one natural person or by more than two partners (physical or entity) that are bound by means of an article of association followed by registration at one of the existing Boards of Trade in each of the 26 states of the federation. The acceptance of a *limitada* with a sole partner has been allowed since September 2019 by means of Law 13,874, which adopted several rulings to reduce bureaucracy in creating companies and to promote the economic freedom to trade in Brazil. The by-laws must include, among other information, the name of the company, the amount of initial funds contributed by the partners and the distribution of representing quotas, the location of the headquarters, the company's purpose, the apportionment of capital to each

quota holder, the appointment of the administrator and personal details of each quota holder and the name of the company manager.

The business format of a *sociedade anônima* resembles that of an American joint-stock company. The corporate entity is governed essentially by Federal Law 6,404, of 15 December 1976. The requirements for setting up a stock company are similar to those for a *limitada*, although it is used for bigger investments and therefore involves the creation of a more complex operational structure, such as a board of directors and an audit committee to examine the management actions, and requires more detailed company books with information about the shareholders and capital increases. Furthermore, only a joint-stock company may place its shares on the stock market by transactions.

To set up a Brazilian subsidiary, a foreign supplier should take into consideration that the a *limitada* requires simpler creation rules and involves fewer disclosure and governance duties.

Clauses stipulated in the by-laws that are contrary to public order and good customs in trade or that conflict with the Federal Constitution of 1988 are not accepted and therefore refused by the authorities of the Board of Trade during the registration procedure of the company. Registration of the by-laws and the company is important to produce effects between third parties, including the liability limitations of debts and responsibilities assumed by the company.

Brazilian law and local jurisdictions should prevail and be stipulated in the by-laws.

Law stated - 6 February 2024

Restrictions

4 Does your jurisdiction restrict foreign businesses from operating in the jurisdiction, or limit foreign investment in or ownership of domestic business entities?

There are certain areas influenced by the public interest and national security philosophy that restrict foreign participation to specific businesses. Such restrictions may be levelled by specific sectors, as follows:

- complete prohibition on foreign participation;
- restriction on foreign ownership; and
- participation with prior approval.

Businesses closed to foreign participation are of a strategic nature to the nation, following up the Federal Constutition of 1988 and Complementing Legislation, such as water supply, mining and broadcast services, among others. The establishment of a local company in this regard and observance of specific conditions to exploit these business sectors is indispensable. Restrictions on foreign ownership encompass, for example, businesses related to aviation, healthcare, electricity and classified government contracts. As to direct foreign participation with prior approval, banking and financial entities are adequate examples.

Law stated - 6 February 2024

Equity interests

5 May the foreign supplier own an equity interest in the local entity that distributes its products?

Yes. There are no legal restrictions imposed on equity participation of foreign suppliers that distribute their products in Brazil. However, importers of foreign medicines and the local distributors to drugstores are required to obtain a licence before the Brazilian Health Regulatory Agency (ANVISA) to operate in the Brazilian market. The requirements are set out by ANVISA's regulations, such as Resolution 39 of 14 August 2013 (amended by Resolution 217 of 20 February 2018 and complemented by Resolution 497 of 20 May 2021). By complying with ANVISA's rules on distribution, a distributor will obtain a Certificate of Good Distribution Practices before ANVISA so that it is allowed to exercise its regular activities of importation and distribution of medicines. ANVISA's requirement for the qualification of a distributor, for example, should be viewed as an exception to distribution, as the Civil Code clearly prevents any bureaucracy on distribution activities.

Law stated - 6 February 2024

Tax considerations

6 What are the tax considerations for foreign suppliers and for the formation of an importer owned by a foreign supplier? What taxes are applicable to foreign businesses and individuals that operate in your jurisdiction or own interests in local businesses?

The power to establish and collect revenues is shared by the federal, state and municipal authorities based on the existing rules in the Federal Constitution of 1988. The federal authorities may collect tax on imports and exports, income and earnings, financial transactions, foreign exchange and transactions with loans and securities, among others. Authorities from the states and federal tax authorities may tax on transmission of property causa mortis or donations any operations related to the circulation of goods and rendering of services from interstate and inter-municipal transportation and communication, operations and services that are initiated abroad, and ownership of motor vehicles, among others. Lastly, municipalities may collect taxes in relation to, among other things, urban buildings and lands, and services of any nature not taxed by the federal authorities.

Different tax liabilities may be applicable to foreign businesses and individuals that operate in Brazil or own interests in local business, depending on the activities concerned. The main tax liabilities are as follows:

- income tax, which is payable by any residents, local companies, associations and corporations domiciled in Brazil;
-

financial transaction tax (IOF), such as credit, exchange and insurance, and securities transactions;

- sales value added tax, which is payable on an added value basis on all physical movement of merchandise;
- service tax, which is payable on gross billings for certain listed services and varies from city to city and according to the type of service rendered; and
- social contribution on profits.

Further to this, foreign suppliers should take into consideration remittance of remuneration overseas in the manner of local distributors to pay and remit a foreign supplier. According to the sparse regulations on foreign capital law, the Brazilian Central Bank (BACEN) is entitled to establish an exchange-control policy, including in respect of the sale and purchase of gold and of any transactions involving foreign currency. BACEN holds the right to restrict exchange transactions when there is a serious risk to foreign reserves. According to the applicable foreign exchange control regulations, remuneration remittances overseas are permitted insofar as they correspond to existing remittance categories set out by BACEN. Royalties from patent licensing no longer requires the recordation aof the patent licensing agreement at the Brazilian National Institute of Industrial Property. Therefore remittances may take place through any authorised bank in Brazil for pyaing out third parties ovreseas without any prior government authorisation. Remittances overseas are levied at between 6 per cent and 25 per cent as withholding tax depending on the nature of remittance. For example, royalties, interest commission fees and service values may be levied at 25 per cent as withholding tax and 0.38 per cent as the IOF.

Law stated - 6 February 2024

LOCAL DISTRIBUTORS AND COMMERCIAL AGENTS

Distribution relationships

7 | What alternative distribution relationships are available to a supplier?

A supplier, especially a foreign one, may trade directly and have its products distributed throughout Brazil by means of different structures expressed in commercial agreements. Seeking partnerships with locals is regarded as the most effective manner to dispose and promote products due to the peculiarities of the market. First, Brazil has a continental territory of 8,515,767 square kilometres with a diverse population of approximately 211 million inhabitants spread out across 26 states. This means that distribution is unusual, as the territory encompasses, for example, the Amazon Forest where goods can only be sent by boat to some regions. Second, each state of the Federation is different and influenced by diverse types of immigration, climate, vegetation, social behaviour, political structure and human and economic development.

Among the alternatives available to suppliers, we point out the following:

- A distribution agreement is the most commonly used tool to promote goods and trademarks in the Brazilian market. Such agreement is understood as a contract

between a supplier and distributors in which the distributors promise to promote the business and goods on the supplier's behalf and interest. The deal occurs under their own name and with their personal promise to sell and deliver the goods (on behalf of the suppliers). The distributor is the party that directly concludes the transaction with the client, and therefore the commercial risks lie entirely with the distributor.

- Agency agreements essentially involve the intermediation of business and promotion of goods and services, but the agent never closes the deal. The supplier is the party who provides the goods directly to the client intermediated by the agent. This means that the agent does not have the goods at his or her disposal and neither does the agent buy or sell goods, but conducts and promotes business opportunities on behalf of the supplier. Agency agreements are governed by articles 710 to 721 of the Civil Code.
- Under the concept of business intermediation or sales representative, a sales representative agreement is also relevant. This is governed specifically by Federal Law 4,886 of 9 December 1965. This law protects the sales representative and gives little room for the contracting parties to negotiate the agreement, especially financial clauses and termination. While an agent encompasses any kind of deal involving the rendering of services or goods delivery, sales representatives relate solely to a commercial goods transaction. Finally, a sales representative must be duly registered as such on the Commercial Representative Council so that the agreement is adequately framed as a sales representative, as agents and distributors are not required to be registered and their activities can be carried out by any person or entity.
- Business format franchising is regarded as a tool to expand goods distribution in the market and at the same time enables the franchisor to main the control required for the quality of products and services. From a legal viewpoint, franchising is a system by which a franchisor grants to a franchisee the right to use a trademark and other intellectual property rights associated with the right to produce or distribute products and to use technology and know-how regarding business implementations and administration or operation systems, either developed by or granted to the franchisor, for direct or indirect remuneration.
- Trademark licensing is an arrangement used by a local licensee that wishes to manufacture or distribute goods locally identified by a third-party brand. The exploitation of licensed trademarks is specifically remunerated by means of royalties. Licensing agreements require the filing and registration of the licensed trademark at the INPI and recordation of the agreement at the same agency to be enforceable against third parties.
- Private labels are practised by big supermarket stores that obtain a large quantity of goods from specific manufacturers with production facilities. The manufacturers are in charge of producing the goods and attaching labels comprising the supermarket brands. The main characteristic of a private labels arrangement is that the supplier's production is entirely bought by a specific distributor, who retails, packages and sells the goods directly under its own brand. The commercial advantage is the guarantee that the supplier will receive profits from the acquisition of the goods and the distributor profits by selling the repacked goods to consumers.
-

There is also the contractual joint venture. One important characteristic of distribution is the general flexibility granted by the laws of the land to the contracting parties to set the contractual covenants, including the possibility to combine different arrangements in one specific contract. The different types of arrangement for distribution into the Brazilian market are also classified as contractual joint ventures, which involve the joint efforts and partnership of two or more persons or entities to supply and dispatch products into the market. Although each partnership or contractual joint venture may contain specific elements and a structure that leads to an existing specific kind of agreement, legal scholars justify such commercial ventures under the 'consortium' concept provided by articles 278 and 279 of the Corporate Law. By accepting the consortium concept, the law recognises the independence of the contracting parties involved in the supply and distribution of goods and the possibility of maintaining an undeclared joint venture that prevents compliance with strict formality. Under the concept of articles 278 and 279 of the Corporate Law, there is also the possibility to set up a specific structure that leads to the organisation of a specific entity, especially a limited liability company, to foster the distribution of products.

Law stated - 6 February 2024

Legislation and regulators

8 What laws and government agencies regulate the relationship between a supplier and its distributor, agent or other representative? Are there industry self-regulatory constraints or other restrictions that may govern the distribution relationship?

A distribution agreement is governed by articles 710 to 721 of the Civil Code. Accordingly, it provides the definition of the business transaction, its characteristics and its requirements. Therefore, a distribution agreement is looked upon as a named contract under the laws of the land, which means that contracting parties will be guided by the general rules of the Civil Code.

There is a kind of distribution that lies outside the scope of the Civil Code, which is the distribution of terrestrial motor vehicles and that addresses specifically the relationship between the vehicle manufacturers and the car dealer. This type of relationship is expressed in a dealership agreement. It is ruled by Federal Law 6,729 of 28 November 1979 (the Ferrari Law). It aims to set adequate rules for dealership businesses by establishing rules to licensed territory, minimum purchase quotas and pricing, among other protective measures for car dealers.

Agency arrangements are also governed by articles 710 to 721 of the Civil Code. Since distribution and agency agreements are addressed by the same set of rules, the elements and requirements for an agency agreement are influenced greatly by legal scholars who work on establishing different concepts between distribution and agency arrangements.

A commercial or sales representative agreement is governed by Federal Law 4,886 of 9 December 1965. It has specific characteristics and requirements as it is a third separate business format for distribution. The activities of a sales representative are specifically related to sales of goods, not service rendering. Registration of the sales

representative at the Commercial Representative Council to exercise the intermediation is a legal requirement.

There are no predetermined conditions or self-regulatory agencies and government approvals provided by the laws of the land for a distributor or agent to perform distribution and agency activities. Nevertheless, there are certain areas where the public interest prevails, and registration and certain requirements are demanded of a distributor. One is the distribution of medicines in Brazil. Importers of foreign medicines or pharmaceuticals and local distributors to drugstores are required to obtain a licence before the Brazilian Health Regulatory Agency (ANVISA) to operate in the Brazilian market. The requirements are set out by ANVISA's regulations, such as Resolution 39 of 14 August 2013 (amended by Resolution 217 of 20 February 2018). By complying with ANVISA's rules on distribution, a distributor will obtain a Certificate of Good Distribution Practices before ANVISA so that it is allowed to exercise its regular activities on importation and distribution of medicines.

Law stated - 6 February 2024

Contract termination

9 Are there any restrictions on a supplier's right to terminate a distribution relationship without cause if permitted by contract? Is any specific cause required to terminate a distribution relationship? Do the answers differ for a decision not to renew the distribution relationship when the contract term expires?

The rules for terminating a distribution relationship may be freely stipulated by the parties, including the events that may cause it. There is a prevailing understanding that the contract is 'the law between the parties' following the *pacta sunt servanda* principle. This means that the relationship between the parties will essentially be governed by the covenants of the agreement. Unless laws of public order and cogent laws impose specific and mandatory conditions on the contracts, the contracting parties are required to set out the events under which an agreement may be unilaterally terminated. If the events for termination of a distribution relationship are not stipulated in the agreement (as a contractual clause), termination will occur only through court procedure.

Nevertheless, there is a specific termination rule dealing with distribution agreements for an undetermined period. Under this kind of agreement, any party may unilaterally terminate the agreement at any time and without cause by means of a prior written notice of at least 90 days before termination, following article 720 of the Civil Code. The prior written termination notice may be longer, depending on the investment incurred by the distributor for the promotion and distribution of the supplier's products in the market. Larger investments require longer termination notice.

Termination due to the lapse of the contractual term and non-renewal does not have specific legal rules. Therefore, the parties may freely stipulate the non-renewal conditions.

Termination without cause of a sales representative agreement (not an agency agreement) for an undetermined period that has been in force for more than six) months requires prior communication of 30 days or the payment of an amount equal to one-third of the commission obtained by the representative in the last three months prior to termination.

Law stated - 6 February 2024

10 Is any mandatory compensation or indemnity required to be paid in the event of a termination without cause or otherwise?

There is no specific legal rule for compensation or indemnity derived from a termination without cause in distribution agreements or agency with a fixed term. If compensation or indemnity are not specifically set by the parties, compensation may be requested solely in court, where factors such as the investments made by the distributor, the duration of the contract or behaviour of the parties will be taken into consideration by the judge to determine the compensation.

Nevertheless, compensation is set out by Law 4,886/65 under the sales representative agreement when termination takes place by the supplier for reasons outside the scope of the events set out by article 35, as follows:

- of the aforementioned law, such as the representative's negligence in fulfilling the obligations arising from the agreement;
- representative practice acts that result in commercial discredit of the supplier;
- the representative's failure to comply with any contractual obligation;
- the representative is convicted of a crime regarded as infamous; and
- force majeure.

The compensation in this regard should be in an amount not less than one-twelfth of the total commission or remuneration received by the representative during the period that it executed the representation under the sales representative agreement.

Furthermore, indemnity would apply when a sales representative agreement with a fixed term is terminated without cause and outside the scope of article 35. In this matter, indemnity would be in the amount equal to the monthly average of the remuneration earned until the termination date multiplied by half of the number of months resulting from the contractual period.

Law stated - 6 February 2024

Transfer of rights or ownership

11 Will your jurisdiction enforce a distribution contract provision prohibiting or restricting the transfer of the distribution rights to the supplier's products, all or part of the ownership of the distributor or agent, or the distributor or agent's business to a third party?

Rules restricting the transfer of the distribution rights to the supplier's products are valid, as the laws of the land secure to the contracting parties the right to stipulate the terms and conditions of the agreement. Nevertheless, it is important to point out that the restriction may be qualified as an anticompetitive practice when it is likely to limit competition unjustifiably or concentrate economic power to dominate markets or lead to abusive prices.

In the light of the above, the antitrust agency, the Council for Economic Defence (CADE), which is in charge of the administrative proceedings to ensure free competition, shall consider specific aspects, including the peculiarities of the business, the product or service involved, the size of the market, the commercial sector and the nature of the transaction. Furthermore, restricting a covenant on the transfer of the distribution rights to the supplier's products should be accepted, especially when a restriction is established in a reasonable proportion to organise and make distribution more competitive.

Law stated - 6 February 2024

REGULATION OF THE DISTRIBUTION RELATIONSHIP

Confidentiality agreements

12 Are there limitations on the extent to which your jurisdiction will enforce confidentiality provisions in distribution agreements?

There is no limitation on the enforcement of confidentiality provisions in distribution agreements. Confidentiality provisions are fully accepted and enforceable under the laws of the land, as they aim to prevent the disclosure of competitive and secret information about the distributor's or supplier's business or technical information.

Law stated - 6 February 2024

Competing products

13 Are restrictions on the distribution of competing products in distribution agreements enforceable, either during the term of the relationship or afterwards?

Yes, restrictions on the distribution of competing products in distribution agreements are fully enforceable. Competition restrictions may apply to both supplier and distributor. Accordingly, article 711 of the Civil Code sets out that when exclusivity is not expressly provided by the parties in the distribution agreement, there is a general presumption that an obligation will be implied. This presumption applies to distributors and agents by setting out that supplier cannot empower any agent or distributor for the granted territory and the distributor or agent cannot engage in other business that competes with that of the supplier. However, exclusivity and the prohibition to compete during the contractual period must be interpreted restrictively in the sense that it applies to a specific territory and goods and for the contractual period of distribution only.

The parties may provide broader non-compete clauses to extend it to a post-termination period. Clauses restricting activities may be valid and enforceable, especially after termination, insofar as they comply with the following requirements:

- be limited in time, especially if the non-compete clause extends to a period after termination of distribution;

- be limited to a specific territory where the distributor is used to represent the supplier;
- be limited to a specific market segment;
- be reasonable; and
- be technically justified.

Law stated - 6 February 2024

Prices

14 | May a supplier control the prices at which its distribution partner resells its products? If not, how are these restrictions enforced?

Suppliers, distributors and resellers are free to establish the prices of the products, including arrangements that impose price restrictions on distributors based on the structure of the market and demand. Under the Antitrust Laws, control of prices and commercial restrictions on a distributor is allowed in as much as it is commercially justifiable and does not impact negatively on consumers and competitors and does not overburden the distributor financially.

Law stated - 6 February 2024

15 | May a supplier influence resale prices in other ways, such as suggesting resale prices, establishing a minimum advertised price policy, announcing it will not deal with customers who do not follow its pricing policy, or otherwise?

Price fixing, fixing of maximum prices, recommended prices, resale prices and minimum advertised price policy, among others, are regarded as practices commonly adopted by local companies and included in commercial agreements. Such clauses are regarded, in principle, as valid and enforceable especially if there is evidence that they do not limit competition unjustifiably or concentrate economic power to dominate markets or set abusive prices for the distributor or affect consumers unreasonably. If they affect competition, such rules will be under the remit of the Antitrust Laws. The prevailing rule under the local Antitrust Laws is the rule of reason, where the pro-competitive effect of the arrangement will be examined together with the negative impact on competition and consumers' rights.

Law stated - 6 February 2024

16 | May a distribution contract specify that the supplier's price to the distributor will be no higher than its lowest price to other customers?

Yes. A specific covenant of a distribution agreement may determine rules that set the price of the products that the supplier will provide to the distributor and the price offered by the distributor to its customers, especially if such rules aim to make the distributed products

more competitive in the market and lead to an increase in profits without overburdening competitors and consumers.

Law stated - 6 February 2024

17 Are there restrictions on a seller's ability to charge different prices to different customers, based on location, type of customer, quantities purchased, or otherwise?

There are no restrictions that prohibit or limit charging different prices to diverse customers if competition is not affected. Charging different prices based on the peculiarities of customers and special conditions in the market is in fact recommendable, as these are considered market variants.

Law stated - 6 February 2024

Geographic and customer restrictions

18 May a supplier restrict the geographic areas or categories of customers to which its distribution partner resells? Are exclusive territories permitted? Is there a distinction between active sales efforts and passive sales that are not actively solicited, and how are those terms defined?

The parties may set out the contractual territory secured to the distributor based on geographic areas, field of use, relevant markets or categories of customers to which the distributor can resell. The limitation should be adequately tailored by the supplier and stipulated in the agreement so that allegations of unclear and unreasonable restrictions can be raised by distributors.

Exclusivity is permitted within Brazilian territory and should be expressly provided in the agreement, since exclusivity means the exclusion of a natural person or company from distributing the goods on the Brazilian market or in any region of the territory. If exclusivity is granted to a distributor or agent, suppliers will be prevented from competing with the supplier for the specific exclusive granted market. Nevertheless, article 711 of the Civil Law determines that exclusivity would prevail in the case of the absence of a clause.

There is no distinction between 'active sales efforts' and 'passive sales' under the laws of the land and granting rights over a distribution agreement commonly encompasses the practice of sales undertaken by the distributor unless otherwise provided in the agreement.

Law stated - 6 February 2024

19 If geographic and customer restrictions are prohibited, how is this enforced?

This is not applicable, as geographic and customer restrictions are allowed under the freedom to contract principle.

Law stated - 6 February 2024

Online sales

20 | May a supplier restrict or prohibit e-commerce sales by its distribution partners?

A supplier may restrict or prohibit e-commerce sales by its distribution partners and grant e-commerce rights to different distributors. Such a restriction is justified by the fact that digital platforms are viewed as diverse geographic locations with specific rules and different consumer behaviour. Nevertheless, such restriction or prohibition should be expressly provided in the agreement pursuant to article 711 of the Civil Code, which determines that exclusivity would prevail in the case of an absence of such a clause.

The local laws do not require commercial and business reports that establish different territories from physical sales and e-commerce sales nor the obligation to pay any 'invasion fees'. However, invasion fees may be stipulated in the agreement.

Law stated - 6 February 2024

21 | May a distributor or agent restrict a supplier's sales through e-commerce intermediaries into the distribution partner's territory? May it require the supplier to obtain reports of such sales by territory and a payment of 'invasion fees' or similar amounts to the distribution partner?

A distributor or agent may restrict a supplier's sales through e-commerce intermediaries if such a restriction is expressly stipulated in a distribution agreement. Such a restriction is also applicable if the distributor is empowered as an exclusive party to promote and distribute the supplier's products in the local territory. Reports on sales through e-commerce and payment of invasion fees are not legal requirements and they can be freely established by the contracting parties in a manner that limits the supplier's activities in the market. All restrictions on the parties' activities, arrangements and the like are permitted insofar as they are commercially justifiable and do not impose unreasonable hindrances with commercial harm to the parties.

Law stated - 6 February 2024

Refusal to deal

22 | Under what circumstances may a supplier refuse to deal with particular customers? May a supplier restrict its distributor's ability to deal with particular customers?

There are no laws limiting a supplier's refusal to deal with particular customers, as the Civil Code preserves the freedom to contract. However, article 715 of the Civil Law secures indemnification of the distributor in the case a supplier ceases to deliver the goods without reason to the distributor or reduces the amounts in a way that overburdens the distributor's activities or makes the continuation of the agreement uneconomical. Article 715 has been interpreted extensively to encompass situations where a supplier unreasonably limits the distribution of products to specific customers.

Law stated - 6 February 2024

Competition concerns

23 Under what circumstances might a distribution or agency agreement be deemed a reportable transaction under merger control rules and require clearance by the competition authority? What standards would be used to evaluate such a transaction?

Distribution or agency agreements are not subject to reportable transaction and revision or approval by CADE and other agencies as they are ruled by the laws of contracts provided by the Civil Code and ancillary legislation. Therefore, such agreements are not framed in principle as a merger or acquisition that necessarily involves corporation transactions based on structural changes in companies.

Notwithstanding this, associative agreements are transactions under merger review and approval irrespective of the fact that the association arises from a contractual link or the formation of a new legal entity. There are scholars who hold that a distribution agreement should be framed as an association, because efforts, commitments and extensive investment are required by a supplier and a distributor to jointly promote goods in the market. The possible framing of distribution, agency and franchising as associative agreements has led to strong complaints by local business people, as such agreements are highly promoted as an effective mechanism of disposing of goods in the market due to the lack of public control. Another group of scholars holds that distribution agreements are not associative agreements, as the supplier and distributor have diverse objectives in business transactions. Furthermore, the distributor's reputation does not benefit from the distribution agreement, as the goods are identified by the brand of the supplier, not the distributor.

In an attempt to reduce the uncertainty about associative agreements, CADE issued Resolution 17 on 18 October 2016, which provided relevant rulings on their antitrust merger review. Accordingly, an associative agreement has been defined under the antitrust concept as an association of two or more parties that set out a common entrepreneurship for the exploitation of an economic activity insofar as the following requirements are met:

- the agreement stipulates the splitting up of the risks involved and results in economic activity that will be or is exploited by the associative agreement;
- the agreement is executed for a period of more than two years; and
- the contracting parties need to be competitors in the market.

Further to this, an associative agreement will be filed for merger review and approval by CADE solely when one of the parties in the commercial transaction has had gross revenues in Brazil of approximately US$120 million in the fiscal year prior to the transaction and any other economic group involving in the transaction has had an approximate gross revenue of US$15 million in the fiscal year prior to the transaction.

The merger investigation will focus on the impact of the merger on the relevant market. Therefore, extensive information on the merger and the parties involved may be requested,

such as detailed market information, identification of the existing competition, barriers to competition and other competitive dynamics of the relevant examined market.

Law stated - 6 February 2024

24 Do your jurisdiction's antitrust or competition laws constrain the relationship between suppliers and their distribution partners in any other ways? How are any such laws enforced and by which agencies? Can private parties bring actions under antitrust or competition laws? What remedies are available?

Antitrust laws establish requirements concerning the suppression of abusive practices of dominant economic positions and enlist commercial practices that damage competition. Among the listed practices – article 36, paragraph 3 of Federal Law 12,529 of 30 November 2011 – that may influence the enforceability of distribution agreements are:

- the establishment of common prices and sales conditions;
- the adoption of uniform commercial behaviour;
- limitation or restraint on trade or market access by new companies;
- obstacles to the establishment, operation and development of a competing enterprise, supplier, purchase or financer of a certain product or service; and
- the sale of a product to the acquisition of another or to the utilisation of a service.

Therefore, no specific constraints under the competition laws are applicable to suppliers and distributors.

Private injured parties may bring actions before the state courts grounded on antitrust violation following the requirements of article 47 of Federal Law 12,529/2011 and seek compensation for damages.

Law stated - 6 February 2024

Parallel imports

25 Are there ways in which a distributor or agent can prevent parallel or 'grey market' imports into its territory of the supplier's products?

Brazil adopts a national exhaustion of rights in the sense that importation of genuine goods into Brazil necessarily involves prior approval of the brand owner/registrant of the brand at the Brazilian Trademark Office (BTO). Therefore, parallel import practices involve the importation into Brazil of products identified by registered trademarks without the prior consent of the owner. The distributor can prevent this practice of a supplier's genuine products only if the distributor has obtained exclusive distribution rights, as it is an unauthorized parallel import practice (unfair competition).

Law stated - 6 February 2024

Advertising

26 What restrictions exist on the ability of a supplier or distributor to advertise and market the products it sells? May a supplier pass all or part of its cost of advertising on to its distribution partners or require them to share in its cost of advertising?

There are no legal restrictions on distributors or suppliers to advertise, promote and market the products that sell in the market. Therefore, distributors may agree to assume the costs of advertising the products and stipulate conditions for such a promotion or may pass them to the supplier.

Suppliers and distributors should consider existing laws on consumer rights, health, nature and other laws of a public order nature, such as specific label compliance and TV advertising. The Consumer Law makes no distinction between supplier and distribution concerning repair and indemnification derived from false advertising. This means that a consumer may demand the repair and indemnification caused by a product's advertisement from any party involved in the chain of the advertisement, including the supplier, distributor, licensee, trademark owner and others.

Law stated - 6 February 2024

Intellectual property

27 How may a supplier safeguard its intellectual property from infringement by its distribution partners and by third parties? Are technology transfer agreements common?

The most important supplier's procedure to safeguard its intellectual property rights against third-party infringement is the filing and registration of the IP right before the local agencies, including the Brazilian National Institute of Industrial Property (INPI).

Technology transfer agreements are extensively used in Brazil to acquire technology and permit local parties to use the IP rights when they were of the essence. Under the local laws, technology transfer agreements comprise trademark licensing agreements, patent licensing, know-how licence agreements and technical assistance services.

Law stated - 6 February 2024

Consumer protection

28 What consumer protection laws are relevant to a supplier or distributor?

The Consumer Law – Law 8,078 of 11 September 1990 – is regarded as a Public Order Law, meaning that the contracting parties of a distributor agreement cannot refuse to comply with the requirements and obligations of the law. Therefore, the Law applies to any kind of business or agreement that directly affects consumers. One of the most stringent rules is the prohibition on setting any kind of liability limitation for product defects.

Law stated - 6 February 2024

Product recalls

29 Briefly describe any legal requirements regarding recalls of distributed products. May the distribution agreement delineate which party is responsible for carrying out and bearing the cost of a recall?

Recall is a mechanism recognized by the laws of the land that allows suppliers or distributors to go public to inform their customers and general consumers that their products contain defects and pose risks. As article 10 of the Consumer Law sets out that the supplier or distributor cannot place products and services on the market that present high levels of risk to consumer safety, recalls should be followed by the replacement of the risky product without any cost to consumers or proceed with reimbursement for the defective or risky products.

The responsibility for the publication of information about harmful products lies with the distributor who provides the product to the public. However, it is a common practice for the supplier and producer of the harmful or defective products to assume responsibility for the publication and replacement of the goods, since the defects are usually hidden and unnoticed at the time of acquisition.

Law stated - 6 February 2024

Warranties

30 To what extent may a supplier limit the warranties it provides to its distribution partners and to what extent can both limit the warranties provided to their downstream customers?

Limitation of warranties and liabilities between suppliers and distributors is not subject to regulation and therefore parties may determine the rules related to them. However, warranties and liabilities linked to consumer rights, antitrust and other rights protected by public order laws cannot be affected by negotiations between a supplier or distributor.

Hence, the parties must observe the following cumulative procedure to make the limitation of liabilities valid and effective:

- expressly stipulate in the agreement the extent of liability limitation, as limitation cannot be implied;
- comply with the Consumer Rights Law to secure the rights of consumers and other laws of public order; and
- observe the principles of good faith and the social function of contracts.

Law stated - 6 February 2024

Data transfers

31 Are there restrictions on the exchange of information between a supplier and its distribution partners about the customers and end users of their products? Who owns such information and what data protection or privacy regulations are applicable?

There are restrictions on the exchange of information between a supplier and its distributors on end-user of their products in view of the General Data Protection Law or LGPD (Federal Law 13,709 of 14 August 2018) that governs the processing of personal data. The processing of personal data and the exchange of information should comply with specific principles, such as the transparency of collected and stored information, the lawful basis for processing, purpose limitation, data minimisation and proportionality, among others.

The owner of private information is solely the data subject who is the natural person to whom the personal data refer. To use and process personal data, a third party called a controller may obtain authorisation from the data subjects. The processing of personal data may be led directly by the controller or by a processor who processes personal data in the name of the controller.

International sharing of private data is classified as the transfer of data to a company or entity located in a foreign country or international organisation. Accordingly, such a transfer is allowed when:

- the countries or international organisations receiving transferred information hold a level of protection of personal data adequate to the provision of the LGPD;
- the controller offers and evidences the guarantee of compliance with the principles of the LGPD; and
- the rights of the data subject are in the form of specific contractual clauses for a given transfer, standard contractual clauses and codes of conduct.

Furthermore, international transfer may take place when the data subject has given specific consent with prior information about the international nature of the operation.

Law stated - 6 February 2024

32 What requirements apply to suppliers and their distribution partners with respect to protecting the security of customer data they hold?

Suppliers and their distributors in Brazil must adopt security, technical and administrative measures able to protect personal data from unauthorised accesses and accidental or unlawful situations of destruction, loss, alteration or any type of improper or unlawful processing. The applicable requirements are set out by the Public Order Law – Law 13,709 of 14 August 2018 – the LGPD, and include the need for prior approval by the individual person for the transfer of private information from the one company to the other, including private information from supplier to distributor and vice versa.

Law stated - 6 February 2024

Employment issues

33 | May a supplier approve or reject the individuals who manage the distribution partner's business, or terminate the relationship if not satisfied with the management?

A supplier may approve or reject the individuals who manage the distribution partner's business insofar as it is expressly provided in the distribution agreement, which will express the distributor's consent. Although there is no law addressing this matter, the good faith principle sets out that limitations and restrictions on the other contracting party should always be justified and, therefore, rejection would not be unreasonably withheld, especially when excessive costs are placed on the distributor.

Law stated - 6 February 2024

34 | Are there circumstances under which a distributor or agent, or its employees, would be treated as an employee of the supplier, and what are the consequences of such treatment? How can a supplier protect against responsibility for potential violations of labour and employment laws by its distribution partners?

An employment relationship between a distributor's employees and the supplier will take place solely in case the following requirements are met, as set out by the Labour Law (Decree-Law 5,452 of 1 May 1943):

- employees are subordinated in the performance of their activities to the supplier;
- continuous – not occasional – activity is rendered to the supplier;
- salary payment accrues from the rendering of services to a supplier;
- there is exclusivity in the rendering; and
- employees lack risk in rendering the services to a supplier.

The consequences of this treatment would be the supplier assuming all the labour responsibilities and costs, such as wages, payment of the government's social security programmes, applicable taxes and payment of compensation in the case of employment termination.

Since distributors and suppliers are different and independent parties there is essentially no employment relationship between the distributor's employees and the supplier.

Law stated - 6 February 2024

Commission payments

35 | Is the payment of commission to a commercial agent regulated?

The commission of an agent is not regulated by the laws of the land, as the contracting parties will have the freedom to establish the level of commission for the intermediation

of business. Nevertheless, article 714 of the Civil Code guarantees that the agent and distributor should receive remuneration corresponding to the business concluded within the granted territory, even if the business is concluded without the agent's interference. Moreover, the agent shall be guaranteed the right to receive commission from the period of rendering service, notwithstanding the fact the agency agreement is terminated by any means.

Law stated - 6 February 2024

Good faith and fair dealing

36 | What good faith and fair dealing requirements apply to distribution relationships?

Under the Brazilian legal system, all contracts are subject to the principles of good faith and fair dealing. This means that the parties should proceed with fairness and mutual trust when establishing contractual provisions and act as such when exercising their rights and obligations so that the contracting parties may achieve the interest set when executing the agreement. Such principles are governed by articles 113 and 422 of the Civil Code and, therefore, regarded as implied covenants of commercial agreements. There is a general duty of collaboration and an expectation of loyalty between the parties in the negotiation, execution and termination of the agreement.

Law stated - 6 February 2024

Registration of agreements

37 | Are there laws requiring that distribution agreements or intellectual property licence agreements be registered with or approved by any government agency?

Distribution agreements are not subject to any registration before agencies and public authorities. Nevertheless, licensing of industrial property rights (patents, trademarks, utility model, industrial design, among others) is subject to prior recordation at the INPI for the following reasons:

- when royalties are to be remitted overseas;
- when a licensee wishes to fiscally deduct the remitted amount; and
- for the licensee to proceed in court to enforce its contractual rights.

Law stated - 6 February 2024

Anti-corruption rules

38 | To what extent are anti-bribery or anti-corruption laws applicable to relationships between suppliers and their distribution partners?

The Brazilian Anti-Corruption Law (Federal Law 12,846 1 August 2013) is of public order. Therefore, any legal entity and physical person is obliged to comply with its requirements. Although liability for conduct against the interests of a public administration should rest with the legal entity directly responsible, the Anti-Corruption Law opens up the possibility of using the principle of 'disregarding the legal entity' to extend the penalties to other companies and persons when dissimulation by another entity occurs regarding its observance of the Law. Therefore, The Law can be applied to a supplier when a distributor engages in corrupt acts that ultimately benefit the supplier.

Law stated - 6 February 2024

Prohibited and mandatory contractual provisions

39 Are there any other restrictions on provisions in distribution contracts or limitations on their enforceability? Are there any mandatory provisions? Are there any provisions that local law will deem included even if absent?

Distribution agreements are directly influenced by the Consumer Law, the Antitrust Law and the LGPD, among others related to commercial relationships. Such laws require specific mandatory behaviour that cannot be refused by the parties.

Law stated - 6 February 2024

GOVERNING LAW AND CHOICE OF FORUM

Choice of law

40 Are there restrictions on the parties' contractual choice of a country's law to govern a distribution contract?

There are no restrictions on a party's contractual choice of a country's law to rule a distribution agreement. Nevertheless, if the parties do not establish the choice of country in the agreement, the following prevailing rule will apply:

- the place where the contractual obligation is or will be performed *lex loci executionis*; and
- the place where the distribution agreement was proposed when the parties are absent from each other.

Absent events are commonly found in international agreement negotiations through online platforms where the parties are not present.

Law stated - 6 February 2024

Choice of forum

41

Are there restrictions on the parties' contractual choice of courts or arbitration tribunals, whether within or outside your jurisdiction, to resolve contractual disputes?

There are no restrictions on the parties' choice to indicate the prevailing court or arbitration that will resolve conflicts that have arisen from the contractual relationship. However, if a decision is rendered by a foreign court or arbitration, the award will be subject to prior ratification and rendering of an exequatur by the Brazilian Superior Court of Justice (STJ). The ratification process does not involve analysis of the matters dealt with by the foreign court, but rather it will objectively determine if formal requirements have been observed under article 963 of the Civil Procedural Code, such as:

- being issued by a competent authority;
- being preceded by regular citation, even if verified by default;
- being effective in the country in which it was issued;
- not offending Brazilian res judicata;
- be accompanied by an official translation, unless otherwise provided for in a treaty; and
- not containing an offence to public order.

After this procedure, the foreign decision is ratified and the STJ grants the exequatur, which determines the enforceability of the foreign decision.

Law stated - 6 February 2024

Litigation

42 What courts, procedures and remedies are available to suppliers and distribution partners to resolve disputes? Are foreign businesses restricted in their ability to make use of these courts and procedures? Can they expect fair treatment? To what extent can a litigant require disclosure of documents or testimony from an adverse party? What are the advantages and disadvantages to a foreign business of resolving disputes in your country's courts?

Remedies to suppliers and distributors against infringement of the terms of a distribution agreement and dispute resolutions can be obtained through court proceedings, such as a preliminary ex parte injunction to cease the infringement and compensation from the incurred losses. There is no specific legal rule for calculating this compensation. Therefore, the courts will have to take into consideration the investments made by the distributor, for example, the duration of the contract and the actual amount of losses incurred, if possible.

Articles 303 and 402 of the Civil Code and also the Industrial Property Law establish indemnification or compensation parameters. Accordingly, compensation may be established by the most favourable to the injured party of the following criteria: the benefits that would have been gained by the injured party of the violation had it not taken place and the benefits gained by the infringer.

Urgent orders such as ex parte preliminary injunctions may be duly granted by the judges of the state courts to suspend the effects of the judicable patent when there are elements that prove the probability of the alleged claim (*fumus boni iuris*) and the risk of loss or injury to the useful outcome of the lawsuit (*periculum in mora*). The objective of the injunction is to avoid irreparable damage or damages that would be difficult to recover.

There is no limitation on accessing the local courts by foreigners, nor unfair or discriminatory treatment of a foreign plaintiff, owing to the prevailing Equality Treatment Principle between plaintiff and defendant. If a court action is initiated by a foreign company in Brazil, the local courts may demand that the foreign plaintiff posts bonds (fiduciary guarantee) in court at a rate of 20 per cent of the amount discussed in court unless the foreign company (plaintiff) holds real estate in Brazil. The bonds are regarded as collateral to cover legal fees and the costs of the defendant or party against whom the action is initiated.

Another important principle governing Brazilian civil proceedings is the full disclosure of documents and information about the facts and circumstance by each party that will be taken into consideration by the judge to support his or her decision. Disclosure denials are not accepted when determined by the judge when any legal party holds the obligation to disclose evidence and the documents affect both parties.

Litigation in Brazil is advantageous as the costs involved are reduced and the fact that business law courts usually deliver a final decision within 36 months of the outset. There is always the possibility to appeal to higher courts.

Law stated - 6 February 2024

Alternative dispute resolution

43 Will an agreement to mediate or arbitrate disputes be enforced in your jurisdiction? Are there any limitations on the terms of an agreement to arbitrate? What are the advantages and disadvantages for a foreign business of resolving disputes by arbitration in a dispute with a business partner in your country?

Alternative dispute resolutions are fully accepted and recognised by local laws. Brazil is part of the New York Convention (Recognition and Enforcement of Foreign Arbitral Awards) and arbitration is foreseen in the Arbitration Law (Federal Law 9,307/1996). Accordingly, there is no relevant limitation on the terms of an agreement to arbitrate, as the parties may set out freely the terms and conditions for the arbitration settlement. Also, it is not mandatory for the arbitration clause to be foreseen in the distribution agreements for the parties to elect for arbitration as a form of dispute resolution, since the parties can sign an accessory term, which must be in writing, called a Commitment Term, which unequivocally binds the parties.

Foreign arbitration awards are recognised by the courts of Brazil and, therefore, enforceable. Such awards are subject to the same ratification process and exequatur as foreign decisions.

The advantage of resolving disputes by arbitration is the specialisation of the arbitrators in the legal matters involved. Court specialisation can be found nowadays in the following states of the federation:

- the State Court of Rio de Janeiro has seven chambers on business law matters;
- the State Court of São Paulo recently created two specialist IP first instance courts and, furthermore, two appellate chambers, composed of 14 specialist judges;
- the State Court of Minas Gerais has also inaugurated two specialist business law courts at first instance; and
- the State Court of Rio Grande do Sul has one specialist business law court.

The disadvantage of arbitration in Brazil is the cost involved and the impossibility of appealing to a higher panel.

Law stated - 6 February 2024

UPDATE AND TRENDS

Key developments

44 Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? Are there any other current developments or trends that should be noted?

There are no relevant proposals for new legislation or regulation that would revise or amend the existing laws on distribution and agency agreements.

As to new developments of the applicable laws, there is the applicability of the General Data Protection Law (LGPD) and the Internet Law (Federal Law 12,965 of 23 April 2014). The former deals with the relationship between providers and internet users, including business and consumer transactions and matters of private nature transmitted on digital platforms. Both laws are relevant to e-commerce in Brazil. While the LGPD addresses the processing of personal data of natural persons (information of an identified or identifiable natural person), the Internet Law encompasses the collection, storage, use and grant to third parties of access to data through the internet (connection logs to which this law relates and applies), including the data of companies (as consumers).

There have been discussions on the extension of the applicability of the LGPD to suppliers, especially foreign ones, when a distributor is the party who processes consumers' private data. It has not yet been determined whether the LGPD's obligations extend to suppliers due to their possible close relationship with local distributors or whether suppliers would be liable for penalties for acts committed by distributors in violation of this public order ordinance.

Law stated - 6 February 2024

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Summary

GOVERNING LAW AND CHOICE OF FORUM

UPDATE AND TRENDS

DIRECT DISTRIBUTION

Ownership structures

1 | May a foreign supplier establish its own entity to import and distribute its products in your jurisdiction?

Generally, yes. There is no specific filing or regulatory review process applicable to foreign suppliers looking to establish a business entity or joint venture in Canada. However, if a subsidiary is established in Canada, note that the federal corporate statute and a few provincial corporate statutes set out requirements as to the residency of directors pursuant to which at least one director (or 25 per cent of the directors if there are more than four) must be a Canadian resident.

Law stated - 29 January 2024

2 | May a foreign supplier be a partial owner with a local company of the importer of its products?

Generally, yes. If a subsidiary is established in Canada under the federal corporate statute or certain provincial corporate statutes, at least one director (or 25 per cent of the directors if there are more than four) must be a Canadian resident. Pursuant to the Investment Canada Act, foreign business entities seeking to acquire or establish a Canadian business are required to notify Innovation, Science and Economic Development Canada no later than 30 days following such acquisition or establishment.

Law stated - 29 January 2024

3 | What types of business entities are best suited for an importer owned by a foreign supplier? How are they formed? What laws govern them?

There are several different vehicles available to foreign suppliers who want to carry on business in Canada, each with varying tax and corporate consequences. A foreign supplier may:

- choose to contract directly with a Canadian distributor without carrying on business in Canada directly;
- opt to appoint a local agent or representative to sell its products in Canada;
- opt to carry on business in Canada using a Canadian branch or division; or
- choose to carry on business in Canada through a federally or provincially incorporated subsidiary or other affiliate.

The preferred choice of vehicle used for an importer owned by a foreign supplier to enter the Canadian market is the incorporation of a Canadian subsidiary or other affiliate. Though corporations may be incorporated under Canadian federal law, provinces have also enacted statutes regulating the formation of corporate and other non-corporate

entities, including corporations, unlimited and limited liability companies and partnerships. Business entities must usually register with the relevant corporate or business registry of each province in which they want to conduct business, pay the prescribed fees and file corporate or business registry forms containing basic information about the business and its ownership and management.

Law stated - 29 January 2024

Restrictions

4 Does your jurisdiction restrict foreign businesses from operating in the jurisdiction, or limit foreign investment in or ownership of domestic business entities?

No substantive restrictions on investment exist, except with respect to very large transactions or investments. Pursuant to the Investment Canada Act, foreign business entities seeking to acquire or establish a Canadian business are required to notify Innovation, Science and Economic Development Canada no later than 30 days following such acquisition or establishment. An onerous and thorough review process applies to non-World Trade Organization investors where the asset value of the acquired Canadian business is at least C$5 million for direct acquisitions or C$50 million for indirect acquisitions. However, the C$5 million threshold will apply to indirect acquisitions where the asset value of the acquired Canadian business represents more than 50 per cent of the asset value of the global transaction. The review threshold for World Trade Organization investors as of 2023 was equal to an enterprise value of C$1.287 billion. This threshold is indexed annually based on growth in nominal GDP.

In addition, Canada has a federal system of parliamentary government, and the regulation and administration of certain trans-provincial industries fall within the sphere of federal legislative powers. As for those under provincial jurisdiction, various provinces have regulated certain industries that are viewed as having particular importance or significance. Thus, several federal and provincial statutes place restrictions on specific industries, such as aviation, collections, engineering, farming, fisheries, banking, trusts and loans, securities, broadcasting, telecommunications, insurance, liquor sales, cannabis and industries that involve the exploitation of Canada's natural resources. Depending on the products being distributed, these restrictions may affect international distribution arrangements where the foreign supplier has a direct or indirect presence in Canada.

Law stated - 29 January 2024

Equity interests

5 May the foreign supplier own an equity interest in the local entity that distributes its products?

Generally, yes, subject to certain restrictions.

There are several different vehicles available to foreign suppliers who want to carry on business in Canada, each with varying tax and corporate consequences. A foreign supplier may:

- choose to contract directly with a Canadian distributor without carrying on business in Canada directly;
- opt to appoint a local agent or representative to sell its products in Canada;
- opt to carry on business in Canada using a Canadian branch or division; or
- choose to carry on business in Canada through a federally or provincially incorporated subsidiary or other affiliate.

The preferred choice of vehicle used for an importer owned by a foreign supplier to enter the Canadian market is the incorporation of a Canadian subsidiary or other affiliate. If a subsidiary is established in Canada under the federal corporate statute or certain provincial corporate statutes, at least one director (or 25 per cent of the directors if there are more than four) must be a Canadian resident.

Though corporations may be incorporated under Canadian federal law, provinces have also enacted statutes regulating the formation of corporate and other non-corporate entities, including corporations, unlimited and limited liability companies and partnerships.

Law stated - 29 January 2024

Tax considerations

6 What are the tax considerations for foreign suppliers and for the formation of an importer owned by a foreign supplier? What taxes are applicable to foreign businesses and individuals that operate in your jurisdiction or own interests in local businesses?

Depending on the business structure selected by a foreign supplier wanting to sell goods in Canada, different taxes may apply on its income.

Canadian residents are taxed on their worldwide income, whereas non-residents may be taxed in Canada when they sell taxable property or earn employment income in Canada. If the supplier carries on business in Canada through a fixed place of business or permanent establishment, any income derived in respect thereof will generally qualify as business income that is taxable in Canada on a net income basis.

Canada has entered into taxation-recognition treaties with a large number of countries; if the foreign supplier is from a treaty country, it will generally be exempt as long as it does not carry on its activities through a permanent establishment in Canada.

The income of a non-resident supplier carrying on business through a 'branch' type of operation in Canada will typically be subject to a 'branch tax', which is the income tax that applies when a non-resident corporation carries on a business in Canada through a branch (ie, by itself having offices, employees, files or other aspects of a permanent establishment in Canada) as opposed to a Canadian subsidiary. The base rate for branch tax is 25 per

cent of the Canadian taxable income earned through the branch in Canada, but it may be reduced by tax treaties, if applicable.

If a foreign supplier appoints a local agent or representative to sell its products in Canada, the income earned by the supplier through sales originating from the agent may, depending on the agent's commission or fee structure, be characterised as passive income and subject in Canada to a withholding tax. If so, the agent would be responsible for withholding the tax and remitting amounts to Canadian tax authorities. The standard withholding tax rate of 25 per cent under Canadian income tax legislation is often reduced to 10 per cent by tax treaties, if applicable.

Canadian withholding tax on passive income would not be payable if a subsidiary or other affiliate is established in Canada. Nonetheless, dividends paid to its parent would be subject to a withholding tax of 25 per cent. This rate can be reduced to as low as 5 per cent by tax treaties, if applicable.

In conclusion, a thorough review of all relevant Canadian legislation pertaining to each structure and a careful evaluation of the effect of tax treaties entered into and ratified by Canada with the foreign supplier's jurisdiction, on a case-by-case basis, is strongly advised.

Law stated - 29 January 2024

LOCAL DISTRIBUTORS AND COMMERCIAL AGENTS

Distribution relationships

7 | What alternative distribution relationships are available to a supplier?

There are a number of options available to suppliers for establishing a distribution structure. The most common structures and their principal features are outlined below.

- Direct distribution: the foreign supplier uses a Canadian subsidiary or its own employees to sell goods in Canada.
- Independent agents and representatives: the supplier relies on an agent or representative to originate sales of goods in Canada and pays them a commission on the goods sold to customers in Canada.
- Trademark licensing: the supplier gives a Canadian entity a licence entitling it to use its intellectual property rights to manufacture and distribute goods for the Canadian market.
- Franchises: this gives rise to special considerations given that several Canadian provinces have either enacted (namely, Ontario, British Columbia, Alberta, Prince Edward Island, New Brunswick and Manitoba) or proposed to enact (namely, Saskatchewan) franchise-specific legislation (the Franchise Acts), under which the term 'franchise' is broadly defined. As a result, a variety of other contractual relationships, including distribution, agency and trademark licensing agreements, may possibly be encompassed. Prior to formalising any particular distribution, agency or trademark licensing arrangement for Canada, parties should carefully examine provincial legislation and consider whether they would be subject to franchise legislation, which entails a duty of disclosure and fair dealing and may

give rise to additional requirements for a supplier that are not generally intended in the context of a distribution, agency or trademark licensing arrangement.

- Private label: a Canadian distributor sells the foreign supplier's products under its own name and trademark. This allows the foreign supplier to sell products in Canada while having the benefit of being recognised under local brand name. However, it generally provides very little control by the supplier.
- Joint ventures: the supplier relies on a local distribution partner that is owned in part by the supplier.

Each of the above can be established by a contractual arrangement, and the parties are generally free to determine their respective rights and obligations under the agreement, subject to certain restrictions.

Law stated - 29 January 2024

Legislation and regulators

8 What laws and government agencies regulate the relationship between a supplier and its distributor, agent or other representative? Are there industry self-regulatory constraints or other restrictions that may govern the distribution relationship?

In general, parties to a distribution or agency agreement are free to establish the terms of their relationship by contract, subject to the expansive definition of a franchise under the Franchise Acts. In addition, certain industries are specifically regulated by federal or provincial law. As a result, care should be exercised when structuring an arrangement that may fall within the ambit of the Franchise Acts or that, by its nature, may be subject to restrictions in a regulated industry.

Additional restrictions arise as a result of competition laws.

Law stated - 29 January 2024

Contract termination

9 Are there any restrictions on a supplier's right to terminate a distribution relationship without cause if permitted by contract? Is any specific cause required to terminate a distribution relationship? Do the answers differ for a decision not to renew the distribution relationship when the contract term expires?

The parties to a distribution or agency agreement can provide for termination without cause in the contract. If the contract stipulates that this termination can occur without notice and with immediate effect, the stipulation will generally be enforced as long as it is provided for in express and unequivocal terms. If the contract is silent as to the requirement to provide notice in the event of a termination without cause, the length of the notice period will vary according to certain factors.

No specific cause is required to terminate a distribution or agency contract. If the contract is silent as to the possibility of terminating without cause, it is generally possible to terminate the arrangement upon reasonable notice. (What constitutes reasonable notice will be determined according to certain factors.)

As for termination with cause, the parties may establish, by contract, occurrences that constitute events of default giving rise to termination. Where the contract is silent, Canadian courts have generally required evidence of a fundamental breach (or, in Quebec, a serious or material breach) to find cause for termination. Short of establishing a cause, the provision of reasonable notice would be necessary to lawfully terminate the relationship. In addition, Quebec law requires that termination rights always be exercised in good faith.

If the contract is for a fixed term, it would naturally expire at the end of the term, and there would not generally be any compensation payable at that time. However, if the parties choose to continue their relationship after the end of the term, it may constitute an implicit renewal or an extension of the contract for an indeterminate term.

Law stated - 29 January 2024

10 Is any mandatory compensation or indemnity required to be paid in the event of a termination without cause or otherwise?

There are no statutory provisions governing compensation upon termination for distribution or agency agreements. In general, courts have found that no compensation is due if reasonable notice has been given, and compensation equivalent to reasonable notice is typically granted where a contract is terminated without notice. The amount of the indemnity, which effectively replaces the notice period, would be estimated based on past profits, and would take into account factors such as the length of the relationship, the nature of the relationship (including whether it was exclusive), industry practice, investments made by the distributor for purposes of the agreement and the time it would take the distributor to obtain a similar source of income from an alternative supplier.

Parties can agree to pre-establish a liquidated damages clause or, pursuant to the Civil Code of Quebec, a termination penalty, and the contractual provision will be enforceable unless it is deemed unreasonable by the courts.

Law stated - 29 January 2024

Transfer of rights or ownership

11 Will your jurisdiction enforce a distribution contract provision prohibiting or restricting the transfer of the distribution rights to the supplier's products, all or part of the ownership of the distributor or agent, or the distributor or agent's business to a third party?

Generally, yes. If the contract is silent with respect to transfers or changes of control, then it is generally assumed that such an operation is permitted without the supplier's consent unless the arrangement constitutes an *intuitu personae* contract.

Law stated - 29 January 2024

REGULATION OF THE DISTRIBUTION RELATIONSHIP

Confidentiality agreements

12 Are there limitations on the extent to which your jurisdiction will enforce confidentiality provisions in distribution agreements?

Confidentiality agreements are normally enforceable under Canadian law, subject to certain exceptions, such as being compelled to disclose under law or in the course of legal proceedings. Under Quebec law, disclosure of confidential information is also permitted for public health or safety reasons.

Information that is publicly available or generic cannot be regarded as confidential. Trade secrets that meet the jurisprudential criteria of being known by only a few people within a given business and are treated as such within that business would be protected irrespective of contractual provisions. However, it is generally prudent to include a contractual provision regarding restrictions on the use of information acquired in the course of the distribution or agency agreement, especially where it could be used by one party to the detriment of the other.

Law stated - 29 January 2024

Competing products

13 Are restrictions on the distribution of competing products in distribution agreements enforceable, either during the term of the relationship or afterwards?

In general, yes, subject to restrictions established by the Competition Act (Canada).

Restrictions on distributing competing products during the term of the relationship are generally enforceable. However, restrictions on competition that extend beyond the term of the agreement must be reasonable and coherent with the contract's purpose and are read restrictively by Canadian courts. Non-competition clauses must be limited with regard to the term, geographic area and activities restricted, the whole in accordance with what is necessary to protect the supplier's or principal's legitimate interests, failing which the provision risks not being enforced in any aspect. Moreover, a supplier or principal would not generally be able to rely on this restriction if the agreement is terminated without cause by them or as a result of their conduct.

Law stated - 29 January 2024

Prices

14 May a supplier control the prices at which its distribution partner resells its products? If not, how are these restrictions enforced?

Price maintenance is a reviewable trade practice under the Competition Act. The threshold for enforcement authorities to apply sanctions on the basis of price maintenance requires that the supplier influence upwards or discourage the reduction of the prices charged or advertised by another business that is either a customer of the supplier or a competitor, and that the supplier's conduct be likely to adversely affect competition. As such, price maintenance would not be recognised in a commercial agency relationship whereby an agent is simply soliciting orders on behalf of its principal rather than purchasing and reselling products itself. It is common for suppliers to provide suggested retail prices on packaging and labels.

The Competition Tribunal may, upon the request of the commissioner of competition, or at the request of a private party with leave from the Competition Tribunal to that effect, make orders for a reviewable trade practice to cease or compel a business to accept a customer or order on reasonable trade terms. Fines may also be applicable if conduct is found to lessen competition.

Law stated - 29 January 2024

15 May a supplier influence resale prices in other ways, such as suggesting resale prices, establishing a minimum advertised price policy, announcing it will not deal with customers who do not follow its pricing policy, or otherwise?

Minimum advertised price policies are common and, while they constitute reviewable trade practices under the Competition Act, they are only viewed as problematic where there is an adverse effect on competition.

Minimum advertised price policies must be established unilaterally by the supplier and must be uniformly enforced. They should also specifically allow products to be sold at prices lower than the minimum advertised price as this provides distributors and agents with the requisite flexibility to offer on-location discounts, coupons and other rebates.

Law stated - 29 January 2024

16 May a distribution contract specify that the supplier's price to the distributor will be no higher than its lowest price to other customers?

Generally, yes. The parties are free to establish their agreed terms of sale in their agreement, including pricing preferences, subject to certain restrictions such as price discrimination, which significantly lessens competition.

Law stated - 29 January 2024

17 Are there restrictions on a seller's ability to charge different prices to different customers, based on location, type of customer, quantities purchased, or otherwise?

Price discrimination and promotional allowances (whether through discounts, rebates, allowances, price concessions or other advantages) are reviewable trade practices under

the Competition Act but would generally only be problematic if they significantly lessen competition.

Law stated - 29 January 2024

Geographic and customer restrictions

18 | May a supplier restrict the geographic areas or categories of customers to which its distribution partner resells? Are exclusive territories permitted? Is there a distinction between active sales efforts and passive sales that are not actively solicited, and how are those terms defined?

Providing for an exclusive territory or other market restrictions in a distribution or agency agreement would not be prohibited, but would be subject to oversight by competition authorities. Unless the restrictions substantially lessen competition, they would not be enjoined.

The distinction between active and passive sales efforts, as it is understood in Europe, is generally not applicable under Canadian law.

Law stated - 29 January 2024

19 | If geographic and customer restrictions are prohibited, how is this enforced?

Geographic and customer restrictions would not be prohibited unless they substantially lessen competition, in which case the reviewable trade practice would be subject to the sanctions and penalties enforced by the Competition Tribunal.

Law stated - 29 January 2024

Online sales

20 | May a supplier restrict or prohibit e-commerce sales by its distribution partners?

As is the case with reselling generally, restricting or prohibiting e-commerce sales altogether or in respect of an exclusive territory in a distribution or agency agreement would not be prohibited, subject to restrictions implemented by the Competition Act. The anticompetitive restraints provided by the Act are applicable to both online and brick-and-mortar retailers. Therefore, territorial restrictions on e-commerce sales would not be prohibited unless they substantially lessen competition.

Accordingly, a supplier may entirely prohibit or otherwise limit e-commerce sales by its distribution partners to a given territory or otherwise, so long as these restrictions do not adversely affect competition. Subject only to the foregoing anticompetitive concerns, the parties are free to establish reporting obligations, and the consequences of any failure to comply with (or deviations from) the contractually established territorial rights, that comply with legal principles applicable in the relevant province.

Law stated - 29 January 2024

21 May a distributor or agent restrict a supplier's sales through e-commerce intermediaries into the distribution partner's territory? May it require the supplier to obtain reports of such sales by territory and a payment of 'invasion fees' or similar amounts to the distribution partner?

As in the case of restrictions on e-commerce sales by distributors, parties to a distribution agreement are also free to establish territorial restrictions on e-commerce sales by the supplier party, as well as impose reporting obligations and consequences in the event of non-compliance (including the payment of 'invasion fees' or other compensation), provided that the restrictions do not adversely affect competition.

Law stated - 29 January 2024

Refusal to deal

22 Under what circumstances may a supplier refuse to deal with particular customers? May a supplier restrict its distributor's ability to deal with particular customers?

Refusal to deal is a reviewable trade practice under the Competition Act and would give rise to enforcement only where the practice substantially lessens competition. A supplier is otherwise free to decide who it chooses to do business with. Restrictions on a distributor's resale rights are generally permissible.

Law stated - 29 January 2024

Competition concerns

23 Under what circumstances might a distribution or agency agreement be deemed a reportable transaction under merger control rules and require clearance by the competition authority? What standards would be used to evaluate such a transaction?

In practice, without significant market power or concentration, it is unlikely that a typical distribution arrangement would trigger oversight of this nature.

Mergers and other transactions may be subject to review where they prevent or lessen, or in certain cases are likely to prevent or lessen, competition substantially within a given industry. A substantial prevention or lessening of competition would result from mergers that are likely to create, maintain or enhance the ability of the merged entity, unilaterally or in coordination with other entities, to exercise market power. The Competition Bureau will evaluate market power based on the merged entity's ability, unilaterally or together with other entities, to profitably maintain prices above, or depress prices below, the competitive level for a significant period of time. Competition authorities also consider whether the

operation generates efficiencies that offset the anticompetitive effect to ascertain the overall effect on competition.

Certain types of joint ventures or strategic alliances may be subject to review if they are likely to substantially lessen or prevent competition. Vertical arrangements between suppliers and their customers are assessed on the same basis.

Law stated - 29 January 2024

24 Do your jurisdiction's antitrust or competition laws constrain the relationship between suppliers and their distribution partners in any other ways? How are any such laws enforced and by which agencies? Can private parties bring actions under antitrust or competition laws? What remedies are available?

In addition to the restrictions on prices, territory, customers and e-commerce sales, exclusive dealing is a reviewable trade practice under the Competition Act, but conduct of this nature would not generally be subject to sanctions unless requiring a distributor to purchase its products exclusively from a given supplier is likely to have a significant adverse impact on competition.

Law stated - 29 January 2024

Parallel imports

25 Are there ways in which a distributor or agent can prevent parallel or 'grey market' imports into its territory of the supplier's products?

The sale of grey market products will not generally constitute trademark infringement under Canadian law. However, where a Canadian company is the registered owner of a Canadian trademark, and is distinct from its international supplier or manufacturer, it would be in a position to rely on the provisions of the Trademarks Act to contest parallel imports and the distribution of grey goods.

A distributor or agent would not have any recourse where the trademark is owned by a foreign entity from which the legitimately imported grey market goods and the goods destined to be sold by the distributor or agent originate. A passing-off action may occasionally be successful where the grey market goods do not meet Canadian safety or labelling requirements. Additionally, in some limited circumstances, courts may intervene and exceptionally grant punitive damages, in order to prevent misrepresentations and counter the sale of grey market goods.

As a practical matter, suppliers who sell goods to a wholly owned subsidiary or other affiliate for distribution in Canada should ensure that the local subsidiary or affiliate is the owner of the trademark in Canada. Ensuring that the product is specifically designed and labelled for the Canadian market will also facilitate the preservation of rights against parallel imports.

Holders of a copyright (eg, in a brand logo) are also afforded a certain level of protection against parallel imports under the Copyright Act. To qualify for this supplemental protection, it is recommended that the Canadian distributor be assigned the copyright in Canada rather

than be given an exclusive licence to use it. If the distributor is not an affiliate of the supplier, it may be preferable to allow for the copyright assignment to be reversed at the end of the contract.

Law stated - 29 January 2024

Advertising

26 What restrictions exist on the ability of a supplier or distributor to advertise and market the products it sells? May a supplier pass all or part of its cost of advertising on to its distribution partners or require them to share in its cost of advertising?

In Canada, the federal government generally regulates advertisement through the Competition Act, which prohibits any advertisement that is false or misleading in a material respect. The materiality of the representation is considered in light of whether it may influence a consumer to buy or use the product or service advertised based on the general impression conveyed by an advertisement, in addition to its literal meaning.

Advertising Standards Canada administers the Canadian Code of Advertising Standards, which sets out criteria for acceptable advertising and guidance on inaccurate, deceptive or otherwise misleading claims, statements or representations, as well as price claims, comparative advertising and testimonials.

Most Canadian provinces also have legislation regarding consumer protection and business practices, many of which include prohibitions on false, misleading or deceptive representations made to consumers. Certain legislation also contains specific prohibitions, such as restrictions on using representations that products confer any particular benefit or standard of quality, and restrictions on inaccurately advertising price advantages. Certain provincial legislation provides for more serious protections with respect to the unfair practice of making unconscionable representations.

As for the responsibility for marketing and advertising in a distribution or agency relationship, the supplier and its contractual counterpart may determine their respective contributions by contract.

Law stated - 29 January 2024

Intellectual property

27 How may a supplier safeguard its intellectual property from infringement by its distribution partners and by third parties? Are technology transfer agreements common?

The types of protections available depend largely on the nature of the intellectual property rights in question, but most types of intellectual property benefit from the same types of safeguards as are commonly recognised internationally, and may be exercised by a supplier against both distribution partners and third parties.

Trademarks

Trademarks are protected under the Trademarks Act. Distinctiveness is central to the definition, and a trademark need not be registered to be valid, or even licensed, in Canada. Registration with the Canadian Intellectual Property Office has the advantage of providing nationwide protection of the registered trademark, as opposed to limited protection in geographical areas where a common law mark (ie, an unregistered mark) is known. Foreign trademark owners seeking Canadian trademark registrations may also apply for them by way of the Madrid International Trademark System.

In the distribution and agency context, remedies available to a supplier in respect of its distribution partner (eg, following a breach of exclusive use clauses or the use of a confusing trademark) range from injunctive remedies to passing-off actions. These remedies are also available for infringement and other recognised violations by third parties.

Patents

Innovations that are new, useful and inventive can be protected under the Patent Act- . Patented innovations must be registered with the Canadian Intellectual Property Office to be afforded protection.

Unless otherwise contractually stipulated, the Patent Act provides that a person who infringes a patent is liable to the patentee and to all persons claiming under the patentee for acts of infringement. Injunctive relief and damage claims would be available and may be instituted against distribution partners and third parties who engage in prohibited practices in respect of patented concepts.

Copyright

Copyright is protected under the Copyright Act. Protection is extended, irrespective of registration, for all original works produced in any country that is a signatory of the Berne Convention. However, registration with the Canadian Intellectual Property Office is possible.

Remedies for copyright infringement under the Copyright Act include damages, lost profits and injunctions prohibiting distribution or ordering the destruction of infringing goods. Actions can be brought by the copyright owner against distribution partners or any third parties.

Know-how and trade secrets

There is no statutory protection of know-how or trade secrets in Canada.

Common law, or in the case of Quebec, civil law, affords protection to trade secrets that are known by only a few people within a given business and are treated as such within the business. Parties must also rely on common law tort and contractual undertakings to protect know-how from unauthorised disclosure or use.

Accordingly, the nature of the confidential information that a supplier wishes to protect, as well as the legal consequences arising as a result of its dissemination, should be clearly identified by the contracting parties in their agreement. If this tort occurs, injunctive relief and damages may be sought by a supplier against a distributor or any third party before the provincial courts with competent authority.

Technology transfer agreements

Technology transfer agreements are not generally used in the distribution and agency context.

Law stated - 29 January 2024

Consumer protection

28 | What consumer protection laws are relevant to a supplier or distributor?

In addition to the advertising rules provided in the Competition Act and the requirements of the Canada Consumer Product Safety Act, most Canadian provinces have legislation regarding consumer protection or business practices, or both.

Additionally, rules relating to warranties and vendor liability may be relevant in the consumer context.

Of importance with respect to online sales, certain provinces in Canada impose specific formalities in respect of distance (or remote) contracts, where a consumer contracts without being in the physical presence of a merchant.

Law stated - 29 January 2024

Product recalls

29 | Briefly describe any legal requirements regarding recalls of distributed products. May the distribution agreement delineate which party is responsible for carrying out and bearing the cost of a recall?

The Canada Consumer Product Safety Act (CCPSA) grants Health Canada, the federal ministry charged with public health matters, sweeping powers to issue mandatory product recalls and require product safety tests. The CCPSA applies where products are usually obtained by an individual for non-commercial purposes and imposes a general threshold of 'danger to human health and safety', which is evaluated on the basis of whether an existing

or potential hazard is posed by a product during its normal use and can cause death or have an adverse effect on an individual's health in the short or long term.

In the case of an incident, a manufacturer or distributor can either voluntarily issue a product recall, or the recall may be ordered by Health Canada. Incidents include the following: occurrences that caused or could have caused death or injury; situations where a dangerous defect is noticed; situations where an incorrect, insufficient or non-existent label creates a risk of death or injury; and situations where another domestic or foreign public body initiates a recall. If a product is subject to a recall, the manufacturer (or, if the manufacturer is foreign, the importer) must provide Health Canada with information regarding the incident and file a mandatory incident report.

Specific risks relating to particular classes of products, including candles, glass items, mattresses, children's jewellery and sleepwear, toys, food, drugs, cosmetics, medical devices, carriages and strollers, cribs, cradles and bassinets, playpens, helmets, car seats, residential smoke detectors, firearms and ammunition, are further dealt with in detailed regulations.

The parties to a distribution or agency arrangement may determine contractually who is responsible for the costs associated with recalls and for carrying out any applicable formalities. However, Health Canada also has the power to initiate a recall under the CCPSA; therefore, the allocation of responsibility established by the parties may be overridden in practice, though contractual indemnities would still apply between the parties.

Law stated - 29 January 2024

Warranties

30 To what extent may a supplier limit the warranties it provides to its distribution partners and to what extent can both limit the warranties provided to their downstream customers?

The supplier and distributor may contractually allocate among themselves the risks relating to products, including with respect to warranties. Products may usually be sold by a supplier to a distributor without any warranty at all. However, the extent to which implied warranties may be disclaimed varies by province, and certain exceptions apply. For example, in Quebec, a seller may not be able to disclaim damages if it has knowledge pertaining to deficiencies relating to the quality of its products, if it commits gross fault or negligence, or where bodily or moral harm occur. In addition, downstream customers other than a first-hand purchaser could have recourse against the manufacturer and other members of the distribution chain if a product suffers from a safety defect.

With respect to consumer warranties, most Canadian provinces have 'sales of goods' legislation that regulate them and prohibit limiting consumer warranties contractually. In Quebec, strict liability applies to product defects under consumer protection law, and neither the distributor nor the supplier may limit consumer warranties; moreover, the benefit of a consumer warranty cannot be waived by a consumer.

Law stated - 29 January 2024

Data transfers

31 Are there restrictions on the exchange of information between a supplier and its distribution partners about the customers and end users of their products? Who owns such information and what data protection or privacy regulations are applicable?

The federal Personal Information Protection and Electronic Documents Act (PIPEDA) contains significant protections for individuals whose personal information may be collected, used and shared by people or entities with which they have dealings. PIPEDA requires that individuals provide informed consent before their personal information is processed and shared, and the individual concerned must be informed of the projected uses of the data in advance. The law also requires disclosure where data may be processed or stored in other countries or by entities other than the one collecting the data, whether domestically or abroad, even if the processing or storage is done on behalf of the entity collecting the data. Additionally, organisations subject thereto may, in certain circumstances, be required to report and maintain records of security breaches involving personal information under their control.

One of the purposes of PIPEDA's adoption was to align Canadian legislation with the European Union's strict privacy requirements. However, in light of the Anti-terrorism Act 2015, which grants the government broad access to personal information for national security reasons, and, the invalidation of the US Privacy Shield by the EU Court of Justice in *Data Protection Commissioner v Facebook Ireland and Maximillian Schrems* (C-311/18, 2020) (*Schrems II*), it is likely unwise to assume that the current Canadian legislation satisfies the EU's highly protective privacy standards, especially in light of the enactment of the EU General Data Protection Regulation (GDPR) in 2018. While Canadian privacy legislation has not been directly challenged and, in light of the *Schrems* decision, is likely the preferred regime in North America, Canadian businesses that store or process personal information about EU citizens should be mindful of how the principles of GDPR may affect their practices.

Inspired by GDPR and California's privacy regime, the federal government has recently introduced yet another bill known as the Digital Charter Implementation Act, which comprises the Consumer Privacy Protection Act which would replace certain provisions of PIPEDA in an attempt to modernise Canadian private sector privacy laws and to strengthen enforcement by addressing the challenges of new technologies and imposing onerous penalties for non-compliance. While the bill is still under review, the goal is to establish consistency with foreign privacy law regimes to provide a competitive advantage to Canadian businesses dealing with personal information. The provinces of Quebec, Alberta and British Columbia have enacted privacy legislation that extends similar protections to individuals and applies to private sector entities under provincial jurisdiction. The province of Quebec has also recently enacted amendments to its private sector privacy regime, which impose various new requirements, such as the mandatory appointment of an internal privacy officer, breach reporting and record-keeping requirements, heightened consent requirements, and mandatory privacy impact assessments when data is transferred outside Quebec and in the context of numerous types of IT projects; the rules also strengthen enforcement measures with significant penalties. Privacy obligations imposed on businesses may also extend to third parties for whom personal information is being

collected. These amendments render Quebec's privacy regime more onerous than its federal, provincial and foreign counterparts in numerous respects.

The parties to a distribution or agency agreement may contractually stipulate, as between them, who 'owns' or 'controls' the information collected from customers and end users (although Canadian privacy law does not consider that data consisting of personal information is 'owned' by those who collect, transmit or use it), but the restrictions described above will apply to all of those who collect, use, share and store such information.

Law stated - 29 January 2024

32 What requirements apply to suppliers and their distribution partners with respect to protecting the security of customer data they hold?

Suppliers and their distribution partners are responsible for complying with the federal and provincial privacy legislation applicable to the customer data held. This would include collecting, processing and disclosing personal information only for the purposes for which valid consent has been obtained from the customers to whom such information relates.

Given that distributors are client-facing, it is usually the distributor's responsibility to ensure that adequate consent is obtained from customers to enable the distributor to legally disclose any personal information collected from customers to the supplier, including the transfer of the personal information to a supplier outside the province in which the customer is located. Suppliers must therefore ensure that their distributors contractually agree to comply with all applicable privacy laws and obtain valid consent from customers for them to be in a position to legally utilise the customer information collected for their own purposes.

Law stated - 29 January 2024

Employment issues

33 May a supplier approve or reject the individuals who manage the distribution partner's business, or terminate the relationship if not satisfied with the management?

In general, the parties are free to govern their relationship by contract, including granting the supplier approval rights over the individuals who manage the distribution partner's business or termination rights as a result of reasonably objective management failures to comply with the stated objectives or obligations of the distribution relationship. However, this may not be the case with distribution arrangements subject to Franchise Acts or in industries that are subject to certain specific regulations and legislation, such as aviation, collections, engineering, farming, fisheries, banking, trusts and loans, securities, broadcasting, telecommunications, insurance, liquor sales, cannabis and industries that involve the exploitation of Canada's natural resources.

Without specific contractual provisions producing the desired effect, a supplier's dissatisfaction with the distributor's management would generally not be considered sufficient cause to terminate a distribution relationship without notice.

Law stated - 29 January 2024

34 Are there circumstances under which a distributor or agent, or its employees, would be treated as an employee of the supplier, and what are the consequences of such treatment? How can a supplier protect against responsibility for potential violations of labour and employment laws by its distribution partners?

Each Canadian province has enacted its own health and safety, employment standards and labour relations legislation. Accordingly, provincial laws and regulations govern most matters relating to labour law.

Depending on the nature of the relationship, there is a risk that a distributor or agent may be considered an employee, in which case the supplier would be subject to mandatory rules applicable to minimum wage rates, overtime wages, vacation and leave compensation, hours of work, severance and notice periods, as well as union certification and collective bargaining laws, all of which vary greatly by province and industry.

To mitigate these risks, the parties may specify by contract that they are independent contractors and cannot be responsible for each other's actions, including in connection with labour and employment matters.

To avoid any unintended characterisations, care must be taken to ensure that each distribution partner operates as a distinct and truly independent entity from a supplier (ie, no common control or direction emanating from the supplier that is greater than that typically characterising the distribution or principal–agent relationship) to be considered a separate employer for labour union certification and collective bargaining purposes.

Law stated - 29 January 2024

Commission payments

35 Is the payment of commission to a commercial agent regulated?

The parties are generally free to establish the agent's compensation by contract. To the extent that commissions attract withholding tax, the agent will be responsible for withholding the applicable amounts and remitting them to the tax authorities in Canada on behalf of the principal.

Law stated - 29 January 2024

Good faith and fair dealing

36 What good faith and fair dealing requirements apply to distribution relationships?

The Supreme Court of Canada has found that there is an inherent duty for parties to honestly perform their contractual obligations, and many common law courts have held that an implicit obligation of good faith exists in contractual dealings. According to this series of

court decisions, the duty of honest performance precludes a contracting party from actively deceiving or knowingly misleading its contractual counterpart, including by way of omission or even silence, depending on the particular circumstances.

The Supreme Court of Canada has also found that the duty to exercise discretion in good faith, like the duty of honest contractual performance, is not an implied term that can be contractually excluded but rather a general principle of law that applies to all contracts, including distribution relationships. This duty is breached when contractual discretion is exercised in an unreasonable manner, meaning that it is unrelated to the purposes for which discretion was granted.

A perhaps more fulsome obligation exists under articles 6, 7 and 1375 of the Civil Code of Quebec, which imposes a duty on all parties to conduct themselves in good faith in all contractual dealings, including at the pre-contractual stage.

Additionally, the Franchise Acts, which may apply to certain types of distribution agreements, include an explicit duty of good faith and fair dealing during the term of the contractual relationship.

Law stated - 29 January 2024

Registration of agreements

37 Are there laws requiring that distribution agreements or intellectual property licence agreements be registered with or approved by any government agency?

No legislation directly governs international distribution agreements or expressly requires the registration of a distribution agreement with a foreign national with any authorities in Canada, subject to certain restrictions, such as those arising from the Franchise Acts.

There is no requirement to register a trademark licence, and there is no clear adverse effect of failing to do so in a timely manner.

Under the Copyright Act, a copyright licence must be granted in writing and must be signed by the owner of the right in respect of which the licence is granted or by its duly authorised agent. The grant of a copyright licence may be registered, and the rights of any registered licensee will take priority, without notice, over any prior unregistered licensees.

Law stated - 29 January 2024

Anti-corruption rules

38 To what extent are anti-bribery or anti-corruption laws applicable to relationships between suppliers and their distribution partners?

Bribery and corruption of public officials are crimes in Canada under the Criminal Code for both the corruptor and the corrupted official. In addition, the Corruption of Foreign Public Officials Act applies to acts of corruption or bribery committed by Canadian persons outside Canada. Charges may also extend to those who aid or abet offenders.

Law stated - 29 January 2024

Prohibited and mandatory contractual provisions

39 Are there any other restrictions on provisions in distribution contracts or limitations on their enforceability? Are there any mandatory provisions? Are there any provisions that local law will deem included even if absent?

Restrictions and prohibited practices in respect of distribution and agency relationships include, among others, restrictions imposed by federal or provincial law in certain regulated industries, such as aviation, collections, engineering, farming, fisheries, banking, trusts and loans, securities, broadcasting, telecommunications, insurance, liquor sales, cannabis and industries that involve the exploitation of Canada's natural resources, as well as restrictions arising from the Franchise Acts and competition laws.

There are no mandatory provisions or automatic inclusions in contracts and the parties are generally free to set out the terms of their agreement by contract; however' the Canadian judiciary is increasingly inclined to interpret the exercise of contractual rights through a lens that examines their consistency with the fundamental principles of good faith, and may accordingly imply terms in this context.

In certain cases, courts enforcing an agreement in Canada will be required to apply mandatory provisions of local law. Overriding a contract by reason of mandatory local law would generally apply only where either the contract or the parties' conduct is inconsistent with public policy, for which the threshold is no lower in Canada than in other jurisdictions with sophisticated legal systems. Rules that could be considered mandatory in Canada include limitations on restrictive covenants, competition issues, limitations of liability, privacy laws and criminal matters.

Law stated - 29 January 2024

GOVERNING LAW AND CHOICE OF FORUM

Choice of law

40 Are there restrictions on the parties' contractual choice of a country's law to govern a distribution contract?

The parties are free to choose the laws that will govern their relationship. All Canadian provinces permit the selection of a foreign governing law as long as doing so is not considered to be in breach of the domestic law, subject to the application of laws or provisions of public order in Canada.

Canada is party to numerous international treaties such as the Vienna Convention on the International Sale of Goods. Where the selected or applicable law is that of Canada, the foregoing Convention applies automatically unless expressly set aside by the parties in their contract.

Law stated - 29 January 2024

Choice of forum

41 Are there restrictions on the parties' contractual choice of courts or arbitration tribunals, whether within or outside your jurisdiction, to resolve contractual disputes?

Choice of forum clauses are generally enforced by Canadian courts, thus making it possible for the parties to select a non-Canadian court to resolve disputes or claims arising from their agreement, even where they are related to occurrences in Canada. In addition, mediation and arbitration are viable and recognised mechanisms of dispute resolution across Canada.

A final monetary and conclusive judgment on the merits from a foreign court is usually enforced by Canadian courts. Certain provinces, such as British Columbia and Ontario, have enacted legislation that provides a simplified procedure for registering and enforcing foreign judgments and, in certain cases, arbitration awards. Arbitration awards are readily recognised throughout the country as Canada is party to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

Law stated - 29 January 2024

Litigation

42 What courts, procedures and remedies are available to suppliers and distribution partners to resolve disputes? Are foreign businesses restricted in their ability to make use of these courts and procedures? Can they expect fair treatment? To what extent can a litigant require disclosure of documents or testimony from an adverse party? What are the advantages and disadvantages to a foreign business of resolving disputes in your country's courts?

In civil matters, provincial courts generally have jurisdiction except for those matters that are specifically reserved to the federal judiciary (such as intellectual property, bankruptcy, trade and commerce). Injunctive relief is available in all provinces and may be granted on an interim, interlocutory or permanent basis. The right to seek this relief is always within the discretion of the court and cannot be waived.

There is no legal discrimination or heightened level of legal requirements for foreign businesses to adjudicate disputes before courts in Canada. Nevertheless, foreign litigants may be required to post bond for mandatory costs.

The discovery process is an integral part of litigation in Canada and is subject to comprehensive rules of procedure that generally require disclosure of documents and provide for compulsory verbal testimony, each to the extent required to establish the allegations and defences put forth in a given case. There are certain exceptions, such as documents or other information that are subject to attorney–client privilege; however, judicial authorities tend to otherwise allow and encourage submissions and fulsome

disclosures with a view to seeking transparency and avoiding any loss of rights to the parties involved in a dispute.

Law stated - 29 January 2024

Alternative dispute resolution

43 Will an agreement to mediate or arbitrate disputes be enforced in your jurisdiction? Are there any limitations on the terms of an agreement to arbitrate? What are the advantages and disadvantages for a foreign business of resolving disputes by arbitration in a dispute with a business partner in your country?

The parties may expressly and contractually agree to arbitrate their disputes in the venue and in the language of their choosing to the exclusion of Canadian courts. Even in the presence of an unequivocal arbitration clause, certain remedies (such as injunctive relief and other extraordinary recourses) may nonetheless be sought before the courts.

The principal advantages and disadvantages of arbitration for foreign suppliers in Canada are essentially the same as for local suppliers. Arbitration has the main advantage of being confidential. Disputes between suppliers and distributors, or agents, do not become a matter of public record as would be the case with litigation in the judicial system. In addition, arbitration gives the parties a level of control that they may not otherwise have over some aspects of the dispute, such as choice of venue and forum and the selection of an arbitrator with expertise in distribution and agency issues or the relevant technical or specialised fields. Arbitration agreements are final, reliable and not open to appeal; Canadian courts have generally refrained from intervening in such decisions. Finally, arbitration tends to be faster and cheaper than litigation, at least in theory.

As for its disadvantages, arbitration, like litigation, can encounter procedural delays, diminishing the cost and time savings that often motivate its use. The lack of ability to appeal heightens the risk for parties that have no recourse against an unfavourable decision. Some also argue that arbitration clauses that preclude access to the judicial system will prevent the use of proceedings such as injunctive or other equitable relief that can be obtained quickly to effectively end a breach of contract.

Law stated - 29 January 2024

UPDATE AND TRENDS

Key developments

44 Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? Are there any other current developments or trends that should be noted?

In the context of the widespread global effort to combat forced and child labour, the Canadian federal legislature passed Bill S-211 *(An Act to enact the Fighting Against Forced Labour and Child Labour in Supply Chains Actand to amend the Customs Tariff)* in May 2023, which imposes an annual reporting requirement with respect to forced and child labour

in the supply chains of many Canadian businesses, including their operations outside Canada.

The annual report must describe the prevention and risk management measures taken by a business during the previous year with a view to addressing the risks of the use of forced or child labour at any level of the supply chain. It must also contain certain background business information, a description of the business' policies and due diligence processes regarding forced and child labour, and its compliance and mitigating measures. The report must be made available publicly, for example on the business' website, with the first report being due in May 2024.

This legislation also bans the importation of goods produced with any child labour, creates specific enforcement powers, and provides for significant penalties for violations.

Businesses should accordingly prepare to face increased regulatory and enforcement measures with respect to forced and child labour in their supply chains going forward.

Law stated - 29 January 2024

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Summary

GOVERNING LAW AND CHOICE OF FORUM

UPDATE AND TRENDS

DIRECT DISTRIBUTION

Ownership structures

1 | May a foreign supplier establish its own entity to import and distribute its products in your jurisdiction?

Under the current regulatory framework, a foreign supplier may establish its own entity (wholly owned) to import and distribute its products in China, subject to some exceptions, such as certain audiovisual work, and certain agricultural products, where joint venture arrangements remain the requisite structure to attain approval. There are some product categories that are still not open to foreign investors as listed in the Special Administrative Measures (Negative List) for the Access of Foreign Investment (Negative List for Access of Foreign Investment), such as gene diagnosis and therapy and tobacco products, whereby local importers and distributors have to be engaged to import these products.

Law stated - 3 January 2024

2 | May a foreign supplier be a partial owner with a local company of the importer of its products?

A foreign supplier may enter into a joint ownership arrangement with a local company or importer to import its products, except for products that are still not open to local trading by foreign investors. There are two major joint ownership structures: joint ventures in China and limited liability companies invested by the parties in China. For a joint venture in China, there used to be a choice of two types: equity joint ventures and contractual joint ventures. For an equity joint venture, each party was required to make a cash or permitted contribution and share the profits in proportion to its subscribed percentage of the venture's registered capital. However, this requirement was cancelled after the implementation of the Foreign Investment Law, effective from 1 January 2020. Now, an equity joint venture can be established pursuant to the Company Law, which allows parties to share the profits in such manner as agreed by the parties.

On the other hand, parties can invest in limited liability companies with a direct shareholding structure to set up holding companies outside China (using locations such as Hong Kong owing to certain tax considerations), and the Chinese entity can then be placed under the offshore holding structure.

Law stated - 3 January 2024

3 | What types of business entities are best suited for an importer owned by a foreign supplier? How are they formed? What laws govern them?

Unless it is required by law that a joint venture be established, from a corporate management perspective, a wholly foreign-owned enterprise (WFOE) is generally the preferred type of business vehicle for a foreign supplier to import and distribute its own products. A WFOE will be incorporated as a limited liability company in which the foreign

supplier is the only shareholder. The establishment, operation and termination of the WFOE are governed by the Company Law and the Foreign Investment Law. There are different local approval procedures for certain businesses.

Law stated - 3 January 2024

Restrictions

4 Does your jurisdiction restrict foreign businesses from operating in the jurisdiction, or limit foreign investment in or ownership of domestic business entities?

The Chinese regulatory environment is more focused on the regulation of business than on the ownership of business entities, and the scope of business of a business entity is specifically defined in the corporate formation documents. In essence, conducting any business beyond the approved scope of business is illegal. Foreign investors are required to follow the Negative List for Access of Foreign Investment to verify whether the proposed business is prohibited under national and local regulations.

Foreign investors are not allowed to conduct business, or invest, in prohibited industries. The Negative List for Access of Foreign Investment is subject to changes by the government from time to time.

Law stated - 3 January 2024

Equity interests

5 May the foreign supplier own an equity interest in the local entity that distributes its products?

From a corporate management perspective, a WFOE is generally the preferred type of business vehicle for a foreign supplier to import and distribute its own products. A WFOE will be incorporated as a limited liability company in which the foreign supplier is the only shareholder. The establishment, operation and termination of the WFOE are governed by the Company Law and the Foreign Investment Law. There are different local approval procedures for certain businesses.

Law stated - 3 January 2024

Tax considerations

6 What are the tax considerations for foreign suppliers and for the formation of an importer owned by a foreign supplier? What taxes are applicable to foreign businesses and individuals that operate in your jurisdiction or own interests in local businesses?

The major relevant taxes are corporate income tax, value added tax and customs duties. China also follows the Organisation for Economic Co-operation and Development model

on the issue of transfer pricing. The tax authority in China has been using the industrial average profit margin generated from its database to determine whether the assessable income should be adjusted because of certain transfer pricing arrangements between related companies.

Law stated - 3 January 2024

LOCAL DISTRIBUTORS AND COMMERCIAL AGENTS

Distribution relationships

7 What alternative distribution relationships are available to a supplier?

Various distribution relationships are available in China, including the typical relationships of distributors, commission agencies, franchises, trademark licences and joint ventures. Apart from the usual business considerations, such as whether the model can achieve better penetration into the market and serve the objectives of the brand owner, tax issues and actual logistic arrangements are also crucial in determining whether a certain relationship is preferred. For example, it is common to use local agencies for importing cosmetic products because of certain testing procedures of the China Food and Drug Administration, and the distributors are supplied through those local agencies.

Law stated - 3 January 2024

Legislation and regulators

8 What laws and government agencies regulate the relationship between a supplier and its distributor, agent or other representative? Are there industry self-regulatory constraints or other restrictions that may govern the distribution relationship?

Generally, the laws governing rules of contracts under the Civil Code of the People's Republic of China (the Contract Law) govern the relationship. There is no specific government agency that regulates the distribution aspect, though in the context of franchising, the Ministry of Commerce is the regulatory authority that oversees compliance pursuant to the franchise laws and regulations, such as the Regulations of Administration of Commercial Franchising. In recent years, the government has released a series of national standards for different sectors stipulating the necessary standards for the management of different contractual relationships. However, the legal position of these national standards has not yet been defined.

Law stated - 3 January 2024

Contract termination

9 Are there any restrictions on a supplier's right to terminate a distribution relationship without cause if permitted by contract? Is any specific cause required to terminate

a distribution relationship? Do the answers differ for a decision not to renew the distribution relationship when the contract term expires?

The Contract Law does not restrict the supplier's contractual rights to terminate a distribution relationship without cause. The contractual provisions regarding termination are usually descriptive and elaborate in contracts with Chinese parties because some common concepts in other jurisdictions, such as time sensitivity, do not exist under Chinese law.

Law stated - 3 January 2024

10 Is any mandatory compensation or indemnity required to be paid in the event of a termination without cause or otherwise?

The Contract Law does not require the brand owner to provide mandatory compensation or indemnity upon termination of the distribution or similar relationship. There is no requirement under the law to compensate the distributor for the goodwill established by it.

Law stated - 3 January 2024

Transfer of rights or ownership

11 Will your jurisdiction enforce a distribution contract provision prohibiting or restricting the transfer of the distribution rights to the supplier's products, all or part of the ownership of the distributor or agent, or the distributor or agent's business to a third party?

It is common to have change of control provisions in distribution or agency contracts enabling termination of the agreement in the event of transfer of ownership of the distributor or agent to a third party. To date, there has been no specific judicial precedent prohibiting the enforcement of such contractual provisions.

Law stated - 3 January 2024

REGULATION OF THE DISTRIBUTION RELATIONSHIP

Confidentiality agreements

12 Are there limitations on the extent to which your jurisdiction will enforce confidentiality provisions in distribution agreements?

Confidentiality provisions in distribution agreements are generally enforced contractually, and there are also statutory protections under the Anti-Unfair Competition Law. However, the usual challenges relate to the mechanism implemented to protect the confidential nature of the information involved (eg, document marking and restrictions to access), and it is necessary to devise a system to protect this information. The Anti-Unfair Competition Law

(2017 revision) abolished the previous requirement that confidential information should be of 'practical value', and the coverage of confidential information has expanded since 2017.

Law stated - 3 January 2024

Competing products

13 Are restrictions on the distribution of competing products in distribution agreements enforceable, either during the term of the relationship or afterwards?

To date, the judicial precedents have not shown a very systematic approach towards the determination of enforceability of non-compete provisions. Non-compete provisions are generally enforceable during the term of a distribution relationship. It is generally agreed that post-term non-compete provisions are enforceable if the restricted period is not excessively long (eg, a two-year restricted period for the original distribution territory is generally acceptable). To determine the reasonableness of certain restrictions, the general 'fair and reasonable' test, which is relatively vague, is adopted.

Law stated - 3 January 2024

Prices

14 May a supplier control the prices at which its distribution partner resells its products? If not, how are these restrictions enforced?

Generally, distributors and/or agents can be required to follow the supplier's pricing policy. However, in addition to other restrictions, price-fixing arrangements between the supplier and the distributors/agents to monopolise the market are generally prohibited, unless the parties can prove that the price-fixing arrangements and/or price maintenance conducts do not give rise to anticompetitive effects under the Anti-Monopoly Law.

Law stated - 3 January 2024

15 May a supplier influence resale prices in other ways, such as suggesting resale prices, establishing a minimum advertised price policy, announcing it will not deal with customers who do not follow its pricing policy, or otherwise?

The general belief is that this type of most favoured customer provision is enforceable. However, the Anti-Monopoly Law (2022 Amendment) prohibits a distributor from abusing its dominant position in the market to secure certain trading conditions that restrict market entry by other parties. Furthermore, the Anti-Monopoly Law (2022 Amendment) prescribes that an entity (eg, a supplier) shall not organise other entities to reach any monopoly agreement or provide substantive aid to other entities to reach any monopoly agreement.

Law stated - 3 January 2024

16 | May a distribution contract specify that the supplier's price to the distributor will be no higher than its lowest price to other customers?

The general belief is that this type of most favoured customer provision is enforceable. However, the Anti-Monopoly Law prohibits a distributor from abusing its dominant position in the market to secure certain trading conditions that restrict market entry by other parties.

Law stated - 3 January 2024

17 | Are there restrictions on a seller's ability to charge different prices to different customers, based on location, type of customer, quantities purchased, or otherwise?

The law generally does not intervene in the freedom of dealings between the parties on pricing issues. The exception is that under the Anti-Monopoly Law (2022 Amendment), a supplier who is in a dominant position in the market is not allowed to offer different transactional terms and conditions (eg, sale prices) to customers (which refers to the distributor in the present context) with the same conditions without proper reason. There is no statutory definition of 'customers who are of the same conditions', the regulatory authority and the court have wide discretion to determine who may be in breach of this law.

Law stated - 3 January 2024

Geographic and customer restrictions

18 | May a supplier restrict the geographic areas or categories of customers to which its distribution partner resells? Are exclusive territories permitted? Is there a distinction between active sales efforts and passive sales that are not actively solicited, and how are those terms defined?

It is common to agree on an exclusive territory for a particular distributor, and the contractual provisions remain decisive in determining how to define the territories and markets. The law to date has not provided sufficient guidance on construing the contractual provisions on active sales and passive sales that are not actively solicited, but which are heavily litigated in other jurisdictions.

Law stated - 3 January 2024

19 | If geographic and customer restrictions are prohibited, how is this enforced?

Contractual provisions can be agreed by parties on exclusive territory, and civil action can be taken for a violation of those provisions.

Law stated - 3 January 2024

Online sales

20 | May a supplier restrict or prohibit e-commerce sales by its distribution partners?

It is common for a supplier to restrict or prohibit e-commerce sales by its distribution partners in China as e-commerce distribution rights are normally separately granted. Whether restrictions as to the use of e-commerce intermediaries exist is a matter of negotiation between the parties, but the engagement of e-commerce intermediaries has been a growing phenomenon in the past few years. The provisions on territorial limitation as to distribution activities with enhanced technological requirements are seen in most distribution agreements. A supplier may require that its distribution partners, or e-commerce intermediaries, do not sell products outside their assigned territories. Under the highly computerised environment of e-commerce, it is common for suppliers to request their distribution partners to provide more reports as to sales by territory, and some distribution systems have a specific fee or 'invasion fee' for sales outside the authorised territory.

Law stated - 3 January 2024

21 | May a distributor or agent restrict a supplier's sales through e-commerce intermediaries into the distribution partner's territory? May it require the supplier to obtain reports of such sales by territory and a payment of 'invasion fees' or similar amounts to the distribution partner?

Restrictions as to a supplier's sales through e-commerce intermediaries into the distribution partner's territory are a matter of negotiation between the parties. It is not a widespread practice for a distributor or agent to require the supplier to obtain reports of sales by territory or payment of 'invasion fees' to the distribution partner, but instances of this are emerging.

Law stated - 3 January 2024

Refusal to deal

22 | Under what circumstances may a supplier refuse to deal with particular customers? May a supplier restrict its distributor's ability to deal with particular customers?

The Anti-Monopoly Law (2022 Amendment) prohibits businesses that are in a dominant position in the market from refusing to deal with particular customers or from restricting their distributors from dealing with certain parties, without proper reason. There is no statutory definition of 'proper reason', which is subject to determination by the regulatory authority and the courts at their discretion on a case-by-case basis. However, if there is no abuse of a dominant position, this prohibition should not be relevant, and the supplier will be free to devise a policy on the selection of customers.

Law stated - 3 January 2024

Competition concerns

23 Under what circumstances might a distribution or agency agreement be deemed a reportable transaction under merger control rules and require clearance by the competition authority? What standards would be used to evaluate such a transaction?

Under the Anti-Monopoly Law (2022 Amendment), a merger or common control of shareholdings of different competitors entering into arrangements for the control of different competitors may lead to a concentration situation, which is subject to reporting and approval requirements. There are further rules defining what reportable situations are. For example, the concentration is reportable if:

- the annual global sales figure for it is more than 10 billion yuan, when the annual sales figures of two operators in China exceed 400 million yuan; or
- the annual Chinese sales figure for it is more than 2 billion yuan, when the annual sales figures of two operators in China exceed 400 million yuan.

There are a number of relevant standards to be examined, such as:

- the market share and the relative power of control by the operators in such an environment;
- the level of concentration of the market;
- the level of influence of the operator on the entry by others into the market and on technological development;
- the level of influence of the operator on customers and other competitors; and
- the level of influence of the operator on national economic development.

The above is not an exhaustive list.

Law stated - 3 January 2024

24 Do your jurisdiction's antitrust or competition laws constrain the relationship between suppliers and their distribution partners in any other ways? How are any such laws enforced and by which agencies? Can private parties bring actions under antitrust or competition laws? What remedies are available?

The Anti-Unfair Competition Law and the Anti-Monopoly Law (2022 Amendment) are the primary relevant legislation in this respect. Under the Anti-Monopoly Law (2022 Amendment), a supplier that abuses its dominant position in the market and that requires its distributors to purchase products from the suppliers designated by it for the purpose of excluding fair competition is prohibited.

The regulatory authority under the Anti-Unfair Competition Law is the Anti-Unfair Bureau of the Administration for Market Regulation, and the regulatory authority under the Anti-Monopoly Law (2022 Amendment) is the Anti-Monopoly Bureau of the Administration

for Market Regulation. Both authorities have the necessary powers to investigate and impose administrative penalties.

Affected parties are entitled to bring actions under the Anti-Unfair Competition Law or the Anti-Monopoly Law (2022 Amendment) for damages, loss of profits and reasonable investigation costs.

Law stated - 3 January 2024

Parallel imports

25 Are there ways in which a distributor or agent can prevent parallel or 'grey market' imports into its territory of the supplier's products?

At present, Chinese law only allows parallel imports of patented products. The law does not specify whether the parallel import of products under registered trademarks is prohibited. There are cases where the parallel import of products under registered trademarks is regarded as an infringement of trademark rights, but in certain circumstances parallel import of products under registered trademarks may be allowed by local courts in China. It is common to include contractual provisions to restrict parallel imports, but instead of simply relying on the contractual arrangements, brand owners may record their registered trademarks with customs, and as a result, customs will monitor the shipments and seize any infringing products that bear the trademark. A registered patent is also recordable, but customs generally has difficulty monitoring this owing to a lack of technical capability.

Law stated - 3 January 2024

Advertising

26 What restrictions exist on the ability of a supplier or distributor to advertise and market the products it sells? May a supplier pass all or part of its cost of advertising on to its distribution partners or require them to share in its cost of advertising?

A supplier may advertise and market its products pursuant to the Advertisement Law at its own cost, pass all or part of its costs to its distributors or require its distributors to share in its costs upon mutual agreement.

Law stated - 3 January 2024

Intellectual property

27 How may a supplier safeguard its intellectual property from infringement by its distribution partners and by third parties? Are technology transfer agreements common?

China is party to major international conventions on intellectual property protection. Following international practice, patents and trademarks should be registered in China

to secure protection under local laws. Although a copyrighted work created overseas is automatically protected under local laws, in practice, a separate copyright record should be filed before the judicial and administrative authorities to recognise those rights. Trade secrets and confidential information are protected under the Anti-Unfair Competition Law. Information that is not a trade secret or confidential relies heavily on the protection stipulated in the relevant contractual documents between the parties. It is common for owners of intellectual property to enter into different kinds of agreements, such as licensing and technology transfer agreements with local parties.

It is prudent to conduct an audit to review the portfolio before entering into any negotiation with a local party, as there are usually additional issues to be resolved (eg, the Chinese transliteration of the brand should be registered).

Law stated - 3 January 2024

Consumer protection

28 | What consumer protection laws are relevant to a supplier or distributor?

Under the Consumer Interests Protection Law, a distributor is not defined as a consumer and is therefore not protected. However, under Chapter 3 of the Law, the supplier or distributor must fulfil its statutory obligations as a business. For example, when selling its products to a consumer, the supplier or distributor cannot impose unfair or unreasonable transactional conditions on the consumer (eg, a tie-in sale). In addition to the Consumer Interests Protection Law, the Tort Law and the Product Quality Law set out the general obligations and liabilities of suppliers and distributors.

Law stated - 3 January 2024

Product recalls

29 | Briefly describe any legal requirements regarding recalls of distributed products. May the distribution agreement delineate which party is responsible for carrying out and bearing the cost of a recall?

There are several regulations concerning the product recall of specific categories of products, including but not limited to motor vehicle products, drugs, medical equipment and food. Furthermore, China has enacted several administrative regulations related to defective product recalls, such as Measures for the Administration of the Recall of Defective Consumer Goods, Detailed Working Rules for the Recall of Defective Imported Consumer Goods, and Interim Provisions on the Administration of Recall of Consumer Goods (Recall Provisions). Generally, manufacturers are responsible for product recalls and distributors or retailers are obliged to cooperate. A detailed action plan for the product recall must be filed with the authority (ie, a local office of the State Administration for Market Regulation) within a prescribed period.

In general, manufacturers should bear the necessary costs for the recall of consumer goods. With respect to imported consumer goods, the Recall Provisions stipulate that

institutions designated by an overseas manufacturer of imported consumer goods as an agent within the territory of China shall be regarded as a manufacturer; if the overseas manufacturer has not designated an agent in China, the importer shall be deemed as the manufacturer.

Law stated - 3 January 2024

Warranties

30 To what extent may a supplier limit the warranties it provides to its distribution partners and to what extent can both limit the warranties provided to their downstream customers?

With the exception of the mandatory warranties set out in the Product Quality Law, which covers the basic requirements on safety, use and the written descriptions and instructions of use, the supplier and the distributors are free to negotiate additional warranties in their contractual arrangements and to agree on the warranties to be offered to their downstream customers.

Law stated - 3 January 2024

Data transfers

31 Are there restrictions on the exchange of information between a supplier and its distribution partners about the customers and end users of their products? Who owns such information and what data protection or privacy regulations are applicable?

Although the law is silent on the ownership of the personal data of customers and end users, according to the Consumer Interests Protection Law, business operators that collect the personal data of their consumers (including end users) are required to keep the information strictly confidential. Consent must be obtained from consumers before the exchange of personal data between a supplier and its distributor. The provisions on protecting the personal information of telecommunications and internet users, which are a general set of rules for the internet environment, further regulate the collection and use of personal data on the internet by dividing personal data into different categories with different protection for each category.

The first Cybersecurity Law was passed in 2016 and was implemented on 1 June 2017. Under this Law, critical infrastructure providers (ie, companies running infrastructure critical to the economy, such as banks, telecom companies, insurance companies and public services) must store all users' data on Chinese servers and undergo a security check if they want to transfer data out of the country.

Furthermore, an updated national standard on personal information, the Information Security Technology – Personal Information Security Specification (GB/T 35273-2020) (the 2020 Specification) has been in effect since 1 October 2020. Although the 2020 Specification is not mandatory under the law, it is adopted by local authorities to evaluate

an entity's compliance with the legal guidelines and regulations of China. Under the 2020 Specification, personal information collected and generated in China can be transferred overseas, but the controller that collects personal information for providing a product or service must comply with all relevant national regulations and standards (eg, conduct security impact assessments in advance if applicable).

The Data Security Law and the Personal Information Protection Law came into force in September 2021 and November 2021. The Personal Information Protection Law regulates the protection of personal information, and some of its requirements are similar to those under the European Union's General Data Protection Regulation. Under the Personal Information Protection Law, before a data handler transfers personal information to a third party within China or overseas, it needs to obtain the data subjects' consent. Furthermore, with respect to transferring data overseas, the data handler must ensure that the foreign recipient of the data follows data protection requirements that are on the same level as those imposed by the Personal Information Protection Law.

Law stated - 3 January 2024

32 What requirements apply to suppliers and their distribution partners with respect to protecting the security of customer data they hold?

As business operators, the supplier and their distribution partners are generally required to keep the personal data of customers strictly confidential. No specific requirements apply to suppliers and distributors on the protection of customer data.

Law stated - 3 January 2024

Employment issues

33 May a supplier approve or reject the individuals who manage the distribution partner's business, or terminate the relationship if not satisfied with the management?

Chinese laws do not restrict these kinds of provisions, but it is advisable to have detailed provisions in this respect as the court normally adopts a relatively restrictive interpretation of these types of clauses.

Law stated - 3 January 2024

34 Are there circumstances under which a distributor or agent, or its employees, would be treated as an employee of the supplier, and what are the consequences of such treatment? How can a supplier protect against responsibility for potential violations of labour and employment laws by its distribution partners?

In general, every business in China has to secure a business licence. From an administrative point of view, contracting with a business that has a business licence effectively designates a commercial relationship between two separate businesses.

Furthermore, it is common to adopt provisions in the distribution agreement stating that the distributor is an independent contractor rather than an employee of the supplier, and the distributor shall be responsible for its own actions.

If the distributor or agent is an individual and a dispute arises as to whether there has been an employment relationship, the courts will consider the following aspects to determine whether there has been an employment relationship ('Notice on determining whether an employment relationship exists' Lao She Bu Fa [2005] No. 12):

- the content of the written agreement between the parties;
- whether the distributor is on the payroll and whether the supplier has paid any statutory social insurance for the distributor;
- whether the distributor has acquired any corporate identification or uniform from the supplier and made any authorised representation as the supplier's representative to the public; and
- whether the distributor completed any job application forms.

However, a properly set up distribution network should not give rise to such concern. The existence of a business licence is the crucial factor in the determination in practice, as once a business relationship has been established, a distributor or agent with a business licence would not be deemed an employee of the supplier.

Law stated - 3 January 2024

Commission payments

35 | Is the payment of commission to a commercial agent regulated?

There are no specific laws or regulations governing the payment of commission to a commercial agent. The general contractual law principles apply.

Law stated - 3 January 2024

Good faith and fair dealing

36 | What good faith and fair dealing requirements apply to distribution relationships?

There are no good faith and fair dealing requirements applicable to distribution relationships in Chinese law. There is a 'fair and reasonable' principle under the Contract Law, but it is not frequently applied. If applied, it is usually used to determine whether certain contractual provisions are oppressive rather than to examine the course of dealing between the parties.

Law stated - 3 January 2024

Registration of agreements

37 Are there laws requiring that distribution agreements or intellectual property licence agreements be registered with or approved by any government agency?

There is no specific requirement for distribution agreements to be registered with any government agencies. Instead, there are recording requirements for intellectual property licence agreements. A trademark licence agreement should be recorded with the Trademark Office. Although recording is not mandatory, without it the licensing arrangement will not bind other third parties. A patent licence agreement should be recorded with the National Intellectual Property Administration and is mandatory, otherwise the licensing arrangement will not bind other third parties. A copyright licence agreement should be recorded with the Copyright Protection Centre and is voluntary.

Law stated - 3 January 2024

Anti-corruption rules

38 To what extent are anti-bribery or anti-corruption laws applicable to relationships between suppliers and their distribution partners?

The Criminal Law provides two categories of corruptive practices offences. The first is against bribes offered to civil servants, and the other is against commercial bribery. There are different thresholds under the current prosecution policy. For example, in individual bribery situations, for bribes offered to non-public officials, the threshold for prosecution is 10,000 yuan. On the other hand, under the Anti-Unfair Competition Law (2019 revision), as long as gifts or invitations may give the subject company or employees an advantage that is unfair to other competitors, any amount (whether provided in cash or in any other form) offered to non-public officials in exchange for business opportunities or interests will be subject to the confiscation of illegal gains and a fine up to 3 million yuan, and if the circumstances are serious, the business licence of the subject company may be revoked.

Law stated - 3 January 2024

Prohibited and mandatory contractual provisions

39 Are there any other restrictions on provisions in distribution contracts or limitations on their enforceability? Are there any mandatory provisions? Are there any provisions that local law will deem included even if absent?

The Contract Law does not impose any specific restrictions or mandatory provisions on distribution contracts. The general contractual principles apply.

Law stated - 3 January 2024

GOVERNING LAW AND CHOICE OF FORUM

Choice of law

40 Are there restrictions on the parties' contractual choice of a country's law to govern a distribution contract?

Chinese laws do not impose any restrictions on the governing law of distribution contracts. However, in practice, if a local party files a lawsuit at a local court and the court proceeds with the case, it is most likely that the governing law as set out in the distribution contract will be deemed as 'cannot be ascertained' by the local court. In that case, Chinese laws will be applied instead.

Law stated - 3 January 2024

Choice of forum

41 Are there restrictions on the parties' contractual choice of courts or arbitration tribunals, whether within or outside your jurisdiction, to resolve contractual disputes?

Chinese laws do not impose any restrictions as to the choice of courts or arbitration tribunals. However, as the performance of the distribution contract takes place within China, it is possible for the Chinese courts to assume jurisdiction over the case despite the choice of venue provisions.

Law stated - 3 January 2024

Litigation

42 What courts, procedures and remedies are available to suppliers and distribution partners to resolve disputes? Are foreign businesses restricted in their ability to make use of these courts and procedures? Can they expect fair treatment? To what extent can a litigant require disclosure of documents or testimony from an adverse party? What are the advantages and disadvantages to a foreign business of resolving disputes in your country's courts?

The procedures of the courts are relatively simple, and normally a case can be closed within approximately a year. Under the present court rules, remedies are limited and certain relief, such as injunctions and specific performance, is not generally available.

Foreign parties' participation in Chinese court proceedings are common nowadays. Quality or predictable judgments can be seen in the courts of major coastal cities, although foreign parties may elect to have the disputes resolved in alternative venues, such as arbitration in Hong Kong because of the language barrier and because Hong Kong arbitral awards are enforceable in China. Under Chinese court and arbitration rules, there are no general disclosure obligations, and the rules of evidence are less flexible (eg, electronic records and evidence should be notarised in the absence of an original available in the storage medium, evidence outside China should be notarised and apostilled, and special attention should be paid at the preparation stage).

Law stated - 3 January 2024

Alternative dispute resolution

43 Will an agreement to mediate or arbitrate disputes be enforced in your jurisdiction? Are there any limitations on the terms of an agreement to arbitrate? What are the advantages and disadvantages for a foreign business of resolving disputes by arbitration in a dispute with a business partner in your country?

There is no formal mediation process, but judges and arbitrators usually suggest ad hoc mediation before the conclusion of the case.

Arbitration clauses that comply with the requirements are generally enforced. The choices of the parties, such as the language, the number of arbitrators and the venue, are generally respected. There are now several arbitration commissions within China, such as the China International Economic and Trade Arbitration Centre (CIETAC) in Beijing, the Shanghai International Arbitration Centre and the Shenzhen Court of International Arbitration.

Arbitration is gaining popularity in cross-border commercial disputes because arbitrators are usually practitioners with substantial experience in the relevant areas, and arbitration proceedings are more flexible in terms of the procedure.

Law stated - 3 January 2024

UPDATE AND TRENDS

Key developments

44 Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? Are there any other current developments or trends that should be noted?

The Law on Foreign Relations of the People's Republic of China (Foreign Relations Law) became effective on 1 July 2023. The Foreign Relations Law establishes a legal regime of China’s extraterritorial jurisdiction for the first time and provides legal authorisation for extraterritorial law enforcement to protect China’s national interests. Furthermore, under the Foreign Relations Law, the State Council and its departments can determine and implement relevant countermeasures and restrictive measures to provide timely responses to foreign sanctions that may affect foreign companies and their operations.

The Supreme People's Court issued a new judicial interpretation dealing with contracts, taht is, the Interpretation on Certain Issues Concerning the Application of the General Rules in Contracts Book of the Civil Code of the People's Republic of China (the Interpretation on Contracts), which came into effect on 5 December 2023. The Interpretation on Contracts contains 69 articles in nine parts, including General Provisions, Conclusion of Contracts, Effect of Contracts, Performance of Contracts, Preservation of Contracts, Modification and Assignment of Contracts, Termination of Rights and Obligations under a Contract, Default Liability and Supplementary Provisions.

Law stated - 3 January 2024

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Summary

GOVERNING LAW AND CHOICE OF FORUM

UPDATE AND TRENDS

DIRECT DISTRIBUTION

Ownership structures

1 | May a foreign supplier establish its own entity to import and distribute its products in your jurisdiction?

Yes. However, specific restrictions may apply if (foreign or domestic) investors do business in the defence, pharmaceutical or financial sectors.

Law stated - 5 February 2024

2 | May a foreign supplier be a partial owner with a local company of the importer of its products?

Yes. There is no specific investment legislation and no minimum percentage of German shareholders required.

Law stated - 5 February 2024

3 | What types of business entities are best suited for an importer owned by a foreign supplier? How are they formed? What laws govern them?

The types of business entities that are best suited are:

- limited liability companies (GmbH and UG);
- stock corporations (AG); and
- limited partnerships (KG).

The criteria for the choice of entity used are liability, taxation, financing, personal involvement and control, and flexibility. For larger companies, a GmbH or an AG are typically best suited. Their shareholders' liability is limited to the respective share capital.

The minimum share capital varies between €50,000 (AG), €25,000 (GmbH) and €1 (for the GmbH subtype, UG). The transfer of shares in a GmbH or a UG typically has to be approved by the other shareholders and notarised, whereas shares in an AG are freely transferable. However, the GmbH is a more flexible and procedurally less demanding form of entity than the AG.

GmbH, UG and AG entities are formed by one or more founding shareholders, who adopt the articles of association and appoint the managing directors, and additionally, in the case of an AG, a supervisory board (of at least three members) in a notarial deed. These entities exist upon registration at the commercial register. Alternatively, a supplier may purchase an existing, inactive shelf company and, as an advantage, start operating immediately.

Partnerships are often preferred for tax reasons, especially the KG, which – for reasons of limiting liability – is often combined with a corporation as a general partner (GmbH & Co KG or AG & Co KG). They require at least two partners.

The governing laws are as follows:

- the Limited Liability Companies Act for the GmbH and UG;
- the Stock Corporation Act for the AG; and
- the German Civil Code and the German Commercial Code for partnerships.

Law stated - 5 February 2024

Restrictions

4 Does your jurisdiction restrict foreign businesses from operating in the jurisdiction, or limit foreign investment in or ownership of domestic business entities?

Generally, no. Foreign businesses operate under the same rules as domestic businesses. By way of exception, the Federal Ministry for Economy and Technology can restrict or prohibit acquisitions of or participation in domestic business entities by individuals or business entities seated outside the European Union, Iceland, Liechtenstein, Norway (together, the European Economic Area) or Switzerland. Preconditions to this are:

- the foreign investor acquires 10 respectively 20 per cent of the voting rights in a German company where the domestic business entity pertains to critical infrastructure sectors (eg, energy, information technology, telecommunications, transport, traffic, health, water, food, finance and insurance; the relevant percentage – 10 or 20 per cent of voting rights – depends on the critical infrastructure sector concerned); or
- the foreign investor acquires 25 per cent or more of the voting rights of any other German company; and
- the acquisition endangers national public order or security (sections 55 to 59 of the Foreign Trade and Payments Ordinance).

Law stated - 5 February 2024

Equity interests

5 May the foreign supplier own an equity interest in the local entity that distributes its products?

Yes.

Law stated - 5 February 2024

Tax considerations

6 What are the tax considerations for foreign suppliers and for the formation of an importer owned by a foreign supplier? What taxes are applicable to foreign

businesses and individuals that operate in your jurisdiction or own interests in local businesses?

A foreign supplier especially has to consider:

- whether the importer itself shall pay income tax or the supplier as owner, or both; and
- whether the supplier might be subject to double taxation (both in Germany and its state of origin) and whether it can be avoided.

To foreign businesses and individuals that operate in Germany, two levels of taxation apply, namely:

- trade tax, which applies to all businesses and individuals in Germany and is paid on taxable earnings (as a local tax, its rate differs from municipality to municipality); and
- income tax, which depends on the business entity.

Corporations are subject to corporate income tax (15 per cent flat rate) and their shareholders are subject to a tax on capital gains and dividends. The average overall tax burden for corporations in Germany is 30 per cent (corporate income tax and trade tax).

A partnership itself is not subject to income tax, but its partners are subject to either corporate (if business entities) or personal (if individuals) income tax.

Individuals pay personal income tax. The tax rate increases with the income (to a maximum of 45 per cent for an income of €250,000), but trade tax payments can be set off against it. Special tax rates apply for dividends and capital gains.

For dividends, capital gains, interest payments and licence fees, withholding tax may apply. This amounts to 25 per cent of the capital gain distributed to the owning business (plus a further solidarity surcharge of 5.5 per cent, which is added to the tax amount). These taxes may be refunded in the case of double taxation if a treaty with the country of origin of the owning business exists.

Law stated - 5 February 2024

LOCAL DISTRIBUTORS AND COMMERCIAL AGENTS

Distribution relationships

7 What alternative distribution relationships are available to a supplier?

Any conceivable distribution relationship is available. The following distribution relationships are typically used.

- In-house sales force, which allows for direct influence on employees and an easy margin calculation but generally entails high labour cost (including social security).
-

Self-employed commercial agents, who sell the products on the supplier's behalf. The supplier keeps direct contact with and sells directly to the customers, with greater control over the activities of the agent and over the margins. Commercial agents have to provide detailed market reports. Unlike an employee's salary, an agent's commission can be exclusively profit-oriented (namely subject to successfully soliciting customers) and linked to the turnover. Within the EU, protective agency law applies, including minimum termination notice and indemnity provisions.

- Distributors, who buy and, thus, take ownership of the products and sell them on their own behalf, adding a margin to cover their own costs. They assume liability and, in return, gain profit from the margin, while the suppliers' margins are rather low. The distributor is obliged and motivated to market and distribute the products that he or she purchases from the supplier and to safeguard the latter's interests. Distributors are subject to limited control by the supplier over their activities but are also less protected than commercial agents.
- Commission agents, who are midway between commercial agents and distributors. They sell products in their own name but for the supplier's account. The supplier bears the sales risk, even if the commission agents have products in a consignment stock to which the supplier retains the title. The supplier can influence the commission agent without observing the strict antitrust law that applies to distributorship agreements.
- Franchisees, who, like distributors, buy and sell products on their own behalf. A franchisee is entitled and encouraged to use the franchisor's trade name, trademarks, know-how and brands, based on the acquired licences of intellectual property rights, to market and sell the goods or services. Franchisors are typically already established within the marketplace, often already with a solid customer base. In return, the franchisee usually pays an initial fee and ongoing royalties. The franchisor, based on the experience acquired with the established business, must disclose the key risks and issues linked to the franchise and often provides assistance and guidelines in the marketing and selling of the goods or services to maintain the brand identity.
- Private label products, namely products produced by the supplier under the trademarks of the retailer (in contrast to manufacturer brands).
- Trademark licences, which are especially used where the trademark owner has already introduced well-known brands but does not have its own manufacturing capacities or knowledge. To enter into a new product market, the licensor can grant licensees, who have the necessary technical and commercial know-how, a licence to produce and sell the products under the licensor's trademark. The agreement usually, but not necessarily, grants an exclusive licence for a certain territory, and it requires maintaining product quality and upholding the brand image.
- Joint ventures, which are joint projects between legally and economically independent companies in which the partners share management responsibility and financial risk. The setting up of a joint venture is based on a common interest of the partner companies that is expressed in a joint venture agreement, which also regulates the distribution of profits and joint control.
-

Concession agreements, aimed at selling the supplier's products within sales areas in department stores, operated by the supplier, typically using the department store's payment system.

Law stated - 5 February 2024

Legislation and regulators

8 What laws and government agencies regulate the relationship between a supplier and its distributor, agent or other representative? Are there industry self-regulatory constraints or other restrictions that may govern the distribution relationship?

Employment contracts

Employment contracts with the in-house sales force are governed by sections 611 to 630 of the German Civil Code (BGB) and several laws on employees' protection.

Commercial agency contracts

Commercial agency contracts are governed by sections 84 to 92c of the German Commercial Code (HGB). The commercial agent is, like the employee, strongly protected, for example, by mandatory rules on minimum notice periods, commission payments and goodwill indemnity.

Distributorship contracts

Most EU member states' laws do not expressly regulate distributorship contracts. However, the legal vacuum was mostly filled by case law, for example, with respect to the supplier's duty to take back unsold stock upon termination of the contract. German agency law applies by analogy to the distributor if the latter is integrated into the supplier's sales organisation and obliged (contractually or factually) to submit the customer data during or upon termination of the contract.

Antitrust law also applies to distributorship contracts. Pursuant to article 6(3a) of the Rome II Regulation, the antitrust regulation of any affected market must be complied with.

Franchise contracts

Franchise contracts are not explicitly governed by statute law. They combine elements of licensing, sales and management of another's affairs. Generally, agency law applies by analogy (see the German Federal Court of Justice (BGH), decisions of 12 November 1986, on mineral water, and 17 July 2002, *Hertz*). Moreover, being standard form contracts (pre-formulated and provided by the franchisor for multiple franchisees), franchise contracts must comply with the quite strict German laws on standard form contracts (BGH, decision of 11 October 2018, *RE/MAX*; comment by Rohrßen, *ZVertriebsR* 2019, 325).

Industry self-regulatory constraints

Certain industry self-regulatory constraints exist, for example, in the automotive industry (where members of the European Automobile Manufacturers Association have agreed to a code of good practice, stipulating minimum notice periods and methods for the resolution of contractual disputes) or in franchising, where members must adhere to the European Franchise Federation's or the German Franchise Association's code of ethics.

Law stated - 5 February 2024

Contract termination

9 Are there any restrictions on a supplier's right to terminate a distribution relationship without cause if permitted by contract? Is any specific cause required to terminate a distribution relationship? Do the answers differ for a decision not to renew the distribution relationship when the contract term expires?

The supplier's right to terminate without cause is restricted. No restriction applies to a decision not to renew the distribution relationship when the contract term expires unless good faith or antitrust law, in rare cases, demand continued delivery.

The principal's and the agent's right to terminate the agency agreement without cause can be contractually agreed upon. However, there are mandatory notice periods to observe, in accordance with section 89(1) HGB, depending on the contractual term (similarly to article 15(2) of the Commercial Agency Directive): the period is one month in the first year, two months in the second year, three months in the third, fourth and fifth years and six months after five years. The notice periods are set by law and cannot be shortened. In the event of contractual extension, the supplier's notice period cannot be shorter than the agent's (section 89(2) HGB). The agreement can be terminated without a notice period only if there is cause (section 89a HGB), and the terminating party cannot reasonably be expected to carry on the contractual relationship until its ordinary termination (taking into account all circumstances of the single case and weighing the interests of both parties).

Pursuant to section 89a (1) sentence 2 HGB, the exclusion or restriction of the freedom of termination is not permitted. An impermissible restriction of the freedom of termination may also be given indirectly by stipulating difficulties in terminating the contract in the form of financial or other disadvantages (BGH, decision of 19 January 2023, Case No. VII ZR 787/21).

If a contract term was not agreed upon, a distributorship agreement can be terminated (sections 314, 573, 620(2) and 723 BGB). The length of the notice period depends on the case, considering also the distributor's investments. For example, one-year periods were deemed suitable in the automotive sector (BGH, decision of 21 February 1995, *Citroën*). In rare cases, a renewal of the relationship may be imposed by antitrust law.

Generally, agency law applies to the termination of franchise agreements (mutatis mutandis). However, longer periods may be deemed necessary in specific cases, for example, if the supplier's product forced the franchisee to make considerable investments.

10 Is any mandatory compensation or indemnity required to be paid in the event of a termination without cause or otherwise?

A commercial agent can claim indemnity if he or she has brought new customers or has significantly increased the business volume with already existing customers, resulting in benefits for the supplier, and if the payment of indemnity can be deemed equitable in the specific case (section 89b HGB). The relevant calculation is based on the commissions earned over the previous 12 months of activity, with both new customers and existing customers with whom the agent has substantially increased the business (while it is no requirement that the agent loses commission; accordingly, agents earning a one-time commission are not per se excluded from an indemnity, cf. ECJ, Case No. C-574/21). The indemnity cannot exceed an amount equal to the past five years' average annual commission (section 89b(2) HGB). The indemnity claim cannot be waived before termination. In case of multi-level distribution, each level of commercial agents can claim indemnity from its principal, whereby the goodwill indemnity that has been paid by the principal to the main agent in respect of the customer base brought by the subagent is capable of constituting, for the main agent, a substantial benefit, thus resulting in an indemnity claim by the subagent against the main agent (cf. ECJ, 13 October 2022, Case No. 593/21, commented by Rohrßen, *ZVertriebsR* 2023, issue 1; details: Thume/Rohrßen, in: *Graf von Westphalen et al.*, HGB (German Commercial Code), 6th ed. 2023, §§ 84 et seq on the entire commercial agency law).

Indemnity may, however, be reduced or even excluded for reasons of equity if the subagent has taken over the position of the main agent after termination and thus continues its activities towards the same customers for the same products in a direct relationship with the main principal instead of the main agent. In this case, the commercial agent (here ex subagent) does not lose its customer base, so there is no loss to be compensated (cf. ECJ, 13 October 2022, Case No. 593/21, BB 2022, 2572, paragraph 37 f., commented by Rohrßen, *ZVertriebsR* 2023, issue 1).

To retain the indemnity, the commercial agent needs to notify the principal within one year of termination; otherwise, he or she loses the right to indemnity. Indemnity is not due if:

- the agent terminates the contract (unless owing to circumstances attributable to the principal or because of the agent's advanced age or illness);
- the principal terminates the contract owing to default attributable to the agent (which would justify immediate termination for cause); or
- the agent, upon agreement with the principal, assigns and transfers its rights and duties under the agency contract to a third person.

The right to indemnity cannot be excluded by the parties unless the agent acts outside the European Economic Area (EEA) (section 92c HGB). This has been confirmed by the European Court of Justice in its ruling on the international scope of the Commercial Agency Directive (decision of 16 February 2017, *Agro Foreign Trade & Agency Ltd/Petersime NV*; cf. Rohrßen*, ZVertriebsR* 2017, 181 et seq). For details on the different levels of protection

of commercial agents in various countries, see *Rothermel, Internationales Kauf-, Liefer- und Vertriebsrecht* (2nd ed. 2021), with overviews of 65 countries in Chapter H.

Distributors can claim indemnity only by analogic application of agency law. A distributor's indemnity can amount to its average annual net margin. For a long time, it was disputed whether a distributor's goodwill indemnity could be excluded under German law in advance when the distributor operates outside Germany but within the EEA. The BGH has recently denied such exclusion, provided the preconditions for analogic application of agency law are given, arguing that agency law restrictions applied to distributorships as well by way of analogy, and hence in the distributor's favour (BGH, decision of 25 February 2016, *Convection-reflow Soldering Systems)*.

In its decision of 24 September 2020, the BGH clarified that the substantial benefits of the principal within the meaning of section 89b (1) sentence 1 no. 1 HGB consists of being able to continue to use the business relationships created by the commercial agent or authorized dealer after termination of the contract. It is therefore a matter of valuing this customer base created by the commercial agent or distributor ('goodwill') (BGH, decision of 24 September 2020, Case No. VII ZR 69/19, juris-paras. 18, 20).

Franchisees can likely claim indemnity based on analogic application of agency law, but this has not yet been ruled out (BGH, decision of 23 July 1997, *Benetton*). The Federal Court of Justice has denied the franchisee's indemnity claim in the single case, but it would quite likely affirm it in the case of distribution franchising, where the franchisee buys the products from the franchisor, arguing that where the franchisee has been entrusted with the distribution of the franchisor's products and, after termination of the contractual relationship, the franchisor alone is entitled to the customers newly acquired by the franchisee during the term of the contract, the situation is similar to distributorship and commercial agency situations (BGH, decision of 29 April 2010, Case No. I ZR 3/09, *Joop*). However, no indemnity can be claimed where the franchise concerns anonymous bulk business and customers continue to be regular customers on a de facto basis (BGH, decision of 5 February 2015) or production franchising (bottling contracts, etc) where the franchisor or licensor is not active in the sector of products distributed by the franchisee or licensee (*Joop*).

Commission agents may also claim indemnity based on analogic application of agency law (BGH, decision of 21 July 2016, *Thomas Philipps)*. The claim can probably be avoided, in particular by excluding the commission agent's obligation to transfer the customer base to the principal (for details, see Franke and Rohrßen*, IHR* 2017, 62–70).

Law stated - 5 February 2024

Transfer of rights or ownership

11 Will your jurisdiction enforce a distribution contract provision prohibiting or restricting the transfer of the distribution rights to the supplier's products, all or part of the ownership of the distributor or agent, or the distributor or agent's business to a third party?

A provision that prohibits the transfer of distribution rights will be enforced (section 399 BGB). Distribution rights are not assignable without the supplier's consent if the supplier

has a reasonable interest in the distributor's or agent's personal performance (sections 613 and 664 BGB).

A transfer of ownership (change of control) cannot be hindered. However, the distributor can agree not to transfer ownership, and, in the event of a breach, the supplier is entitled to damages, including, if possible, retransfer of ownership (section 137 BGB). In addition, the parties can agree on a termination right in the case of change of control.

Law stated - 5 February 2024

REGULATION OF THE DISTRIBUTION RELATIONSHIP

Confidentiality agreements

12 Are there limitations on the extent to which your jurisdiction will enforce confidentiality provisions in distribution agreements?

Limitations exist, especially regarding the draft of standard business terms. Confidentiality provisions shall clarify the scope of confidentiality (what, who and how long). Contractual penalties may only apply if the receiving party culpably breached confidentiality, and the amount of the penalty has to be reasonable (sections 310, 307 and 343 BGB and section 348 HGB).

Law stated - 5 February 2024

Competing products

13 Are restrictions on the distribution of competing products in distribution agreements enforceable, either during the term of the relationship or afterwards?

Non-compete obligations towards distributors and franchisees are enforceable if they conform to antitrust law. Generally, agreements that aim at or result in restraints of competition are prohibited by antitrust law, namely by the German Act Against Restraints of Competition (GWB) and articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU), details: Rohrßen, VBER 2022, EU Competition Law for Vertical Agreements.

Unless agreements contain hardcore restrictions, a safe harbour is provided by the De Minimis Notice of 30 August 2014 and the Vertical Block Exemption Regulation (VBER) (ex Regulation (EU) No. 330/2010, now updated because of the rise of internet sales and replaced by Regulation (EU) No. 720/2022, applying since 1 June 2022 for new agreements and from 1 June 2023 for existing agreements). Agreements between non-competitors are safe if each party's market share does not exceed 15 per cent in any relevant market affected.

If one party's market share exceeds 15 per cent, but all market shares are below 30 per cent, the parties can agree upon a non-compete obligation during the contractual term for a maximum period of five years. For non-competes, EU competition law now provides for new leeway: According to the European Commission so-called evergreening non-competes (ie,

those that are tacitly renewable beyond a five-year term) can also be exempt under the VBER if the buyer can effectively renegotiate or terminate the vertical agreement with a reasonable notice period and at a reasonable cost in such a way that the buyer can effectively swith its supplier (Vertical Guidelines, paragraph 248; cf. Rohrßen, VBER 2022: EU Competition for Vertical Agreements, Chapter 5.22). This time limit does not apply if the products are sold on premises owned by the supplier or leased by the latter from third parties who are independent of the buyer. In any case, the non-compete obligation cannot exceed the term for which the buyer is entitled to occupy the premises. Upon termination of the contractual term, a non-compete obligation involving a party with a market share exceeding 15 per cent, but without market shares exceeding 30 per cent, is valid if it is necessary to protect the know-how granted to the distributor and limited to competing products, to the distributor's premises and to a one-year term.

If one party's market share exceeds 30 per cent, a non-compete obligation and any other restriction of competition can only benefit from the individual exemption under the strict criteria of article 101(3) of the TFEU (efficiency defence).

Restraints within franchisee agreements can be exempted. They are considered not to restrict competition in terms of EU antitrust law if they are essential for running the franchise system (similar to the ancillary restraints doctrine under US law) (cf. Court of Justice of the European Union, 28 January 1986, *Pronuptia*). This is particularly true for non-compete obligations (for details, see cf. Rohrßen, VBER 2022: EU Competition for Vertical Agreements, Chapter 7).

Non-compete obligations towards agents are enforceable. As the principal bears all risks connected with the sale and purchase of the products or services, antitrust law generally does not apply (Guidelines on Vertical Restraints of 10 May 2010, paragraphs 12 et seq, 18 and 49, now replaced by the Guidelines on Vertical Restraints of 30 June 2022, paragraph 29 et seq, with special comments on agency agreements in the platform economy in paragraphs 46 et seq). Specific limits apply under German commercial agency law to post-contractual non-compete obligations that were stipulated before termination: they must be limited to a two-year period, to the agent's territory or customers, and to the contractual products or services, and they must be done in writing and delivered to the agent. The principal is obliged to pay indemnity for the non-compete obligation's term (section 90a HGB).

Law stated - 5 February 2024

Prices

14 | May a supplier control the prices at which its distribution partner resells its products? If not, how are these restrictions enforced?

Generally, a supplier cannot control the resale price or price level of its distributors or franchisees (except for suppliers selling newspapers, magazines and books, section 30 GWB). A violation of this rule represents a hardcore restriction and is therefore generally void (see article 4(a) VBER and Guidelines on Vertical Restraints of 10 May 2010, paragraphs 48 and 223, respectively Guidelines on Vertical Restraints of 30 June 2022, paragraphs 185 et seq.; for practical tips cf Rohrßen, *ZvertriebsR* 2020, 406 et seq.). By

exception, the supplier can enforce the efficiency defence (eg, when introducing a new product or a coordinated short-term, low-price campaign). The supplier can also influence resale prices by recommending resale prices or setting maximum resale prices.

Suppliers can control the price at which they sell the products or services via agents because the antitrust law restrictions do not apply.

However, this strong market position must not be abused. Such abuse is deemed to exist if the supplier, through its own or affiliated dealerships, offers sale prices at the authorised dealer's level of trade that are so low that the dealer is unable to offer them at an economically profitable price and which are only possible for its own or affiliated dealerships by the entrepreneur compensating for their resulting loss. The decision of the Vienna Supreme Court of 17 February 2021 – 16 Ok 4/20d on section 4 paragraph 3 of the Austrian Cartel Act is also significant for Germany due to the comparable legal situation under section 20 paragraph 1 sentence 1 and section 19 paragraph 1 and paragraph 2 No. 1 of the German Act against Restriction of Competition (ARC).

Law stated - 5 February 2024

15 May a supplier influence resale prices in other ways, such as suggesting resale prices, establishing a minimum advertised price policy, announcing it will not deal with customers who do not follow its pricing policy, or otherwise?

A supplier may recommend resale prices or set maximum resale prices if the parties' market shares do not exceed 30 per cent and if the recommendation or maximum resale price is not backed up by further negative (eg, pressure) or positive (eg, incentives) factors from one party (article 101(1) TFEU and article 4(a) VBER), such as announcing that the supplier will not deal with customers who do not follow its pricing policy.

Establishing a minimum advertised price policy is exempt from antitrust law if it is regarded as a recommendation. Otherwise, it can – very rarely – be exempted under the efficiency defence.

If, on the other hand, a supplier announces it will not deal with distributors or franchisees refusing its pricing policy, it will be treated as fixing the selling prices.

Law stated - 5 February 2024

16 May a distribution contract specify that the supplier's price to the distributor will be no higher than its lowest price to other customers?

A most favoured nation or customer clause can be enforced only if agreed between non-competitors and if the parties' market shares amount to a maximum of 30 per cent (otherwise, only the efficiency defence can be used to argue that the clause does not represent a prohibited restriction of competition).

Law stated - 5 February 2024

17

Are there restrictions on a seller's ability to charge different prices to different customers, based on location, type of customer, quantities purchased, or otherwise?

Generally, based on freedom of contract, a seller can charge different prices to different customers. However, this general rule does not apply if a seller:

- holds a dominant or similarly strong market position (sections 19 and 20 GWB and article 102 TFEU); and
- differentiates on grounds of race or ethnic origin. The same is true for grounds of gender, religion and disability. A different treatment is allowed if it is based on objective grounds, especially where it serves to avoid threats, prevent damage, etc (sections 19 and 20 Anti-Discrimination Act).

Law stated - 5 February 2024

Geographic and customer restrictions

18 May a supplier restrict the geographic areas or categories of customers to which its distribution partner resells? Are exclusive territories permitted? Is there a distinction between active sales efforts and passive sales that are not actively solicited, and how are those terms defined?

Whether measures restrict competition and are prohibited is to be determined by the antitrust law of the country in which the measures have an effect (the effects doctrine). Within the European Union or the European Economic Area (EEA), a supplier is generally prohibited from restricting the territories in which or the customers to whom its intermediary sells; such restrictions are generally null and void (article 101(1)b, (2) TFEU and article 53 EEA Agreement). The following restrictions are, however, exempt from the ban owing to block exemption:

- active sales into an exclusive territory or customer group reserved to the supplier or another distribution partner;
- sales to end users if the distribution partner is a wholesaler;
- sales from members of a selective distribution system to unauthorised distributors within the system's territory; and
- sales of components, supplied for incorporation, to customers who would use them to produce analogous products (article 4(b-d and f) VBER 720/2022).

Active sales (now defined in article 1(1)(l) VBER 720/2022) refers to actively approaching actual or potential customers (eg, by direct, unsolicited mail, email, calls or visits) in a specific territory through specifically targeted promotions. Passive sales (now defined in article 1(1)(m) VBER 720/2022) refers to the response to unsolicited requests from individual customers, including advertisements addressed to customers outside exclusive territories or customer groups, if done reasonably.

This also holds true for the internet: in principle, online sales may not be excluded. A supplier may only require its intermediary to meet specific quality standards, especially

in selective distribution systems (Guidelines on Vertical Restraints of 10 May 2010, paragraphs 51 and 54). The European Court of Justice shed further light on internet resale restrictions within selective distribution systems during deliberation on the Higher Regional Court of Frankfurt's request to give a preliminary ruling on how to interpret European antitrust rules, namely article 101 of the TFEU and article 4(b) and (c) of the VBER (decision of 19 April 2016, *Coty Germany,* File No. 11U 96/14 (Kart)). According to the European Court of Justice's decision of 6 December 2017 (*Coty Germany,* Case No. C-230/16), manufacturers of luxury products may stop the distributors within their selective distribution network from selling the goods via third-party platforms if the contractual clause meets the following three conditions: '(i) that clause has the objective of preserving the luxury image of the goods in question; (ii) it is laid down uniformly and not applied in a discriminatory fashion; and (iii) it is proportionate in the light of the objective pursued.' If these *Metro*-criteria for selective distribution (referring to the *Metro* case of 25 November 1977, Reference No. 26/76) are not met, the clause may nevertheless benefit from an exemption under the VBER by reason of article 101(3) of the TFEU, because banning sales via third-party online platforms does not, at least according to the court, under a selective distribution system for luxury goods, constitute a hardcore restriction as listed in article 4 of the VBER, which would otherwise exclude applying the block exemption to the whole vertical agreement (cf. paragraph 47 of the Guidelines on Vertical Restraints of 10 May 2010). In particular, the third-party platform ban would not constitute a restriction of customers in terms of article 4(b) of the VBER, or a restriction of passive sales to end users in terms of article 4(c) of the VBER. The court left open whether this interpretation also applies to goods other than luxury goods and outside selective distribution. The German competition authority made the following declaration immediately via Twitter on 6 December 2017: 'The #ECJ has taken care to limit its findings to genuine luxury products. #Brandmanufacturers have not received carte blanche to issue blanket #platformbans. First assessment: Limited impact on our practice.'

The European Commission disagreed; in its Competition Policy Brief of April 2018, the European Commission stated that the European Court of Justice's argumentation in the *Coty Germany* case applies irrespective of the luxury character of the products marketed:

> *The arguments provided by the Court are valid irrespective of the product category concerned (i.e., luxury goods in the case at hand) and are equally applicable to non-luxury products. Whether a platform ban has the object of restricting the territory into which, or the customers to whom the distributor can sell the products or whether it limits the distributor's passive sales can logically not depend on the nature of the product concerned.*

The European Court of Justice's decision in the *Coty Germany* case provides good abstract arguments that manufacturers of both luxury and other brand-name products may ban their sale via internet platforms either according to the *Metro* criteria or according to the VBER. In this regard, see also the decision of the Higher Regional Court of Hamburg of 22 March 2018, which held that the ban that a producer of food and cosmetics (ie, not luxury goods, but products 'qualitatively committed to a high (production) standard') imposed on its own distributor to sell via third-party internet platforms was valid (for details see Rohrßen*, ZVertriebsR* 2018, 277–285 (281)).

The new VBER has now vastly codified these principles, as in its article 4(e) VBER has added a new hardcore restriction: suppliers must not prevent the buyers' (or their customers') effective use of the internet to sell the contract goods or services, as it restricts the territory into which or the customers to whom the contract goods or services may be sold within the meaning of points.

With regard to resale restrictions, the EU Geo-blocking Regulation (Regulation (EU) No. 2018/302) prohibits traders from discriminating against customers within the European Union for reasons of nationality, place of residence or place of establishment with regard to the access to online interfaces (article 3) and the application of general conditions of access to goods or services (article 4). Within the range of means of payment accepted, traders shall not apply different conditions for payment transactions based on nationality, place of residence, place of establishment of the customer, location of the payment account, place of establishment of the payment service provider or place of issue of the payment instrument within the European Union (article 5). Where distribution agreements impose obligations to exercise any form of unjustified geo-blocking as laid down in articles 3, 4 and 5, those provisions shall be automatically void (article 6(2)). The Geo-blocking Regulation has been in application since 3 December 2018. However, article 6(2) will only apply to agreements on passive sales concluded before 2 March 2018 as of 23 March 2020 (for details see Rothermel and Schulz*, K&R* 2018, 444–449; Rohrßen, *ZVertriebsR* 2018, 277–285 (283–284)).

Law stated - 5 February 2024

19 | If geographic and customer restrictions are prohibited, how is this enforced?

Geographic or customer restrictions of resale, to the extent permitted, can be enforced through private legal action, namely by way of an action for an injunction, requiring the distributor to refrain from such breach of contract. If urgent, suppliers can request an interim injunction.

Law stated - 5 February 2024

Online sales

20 | May a supplier restrict or prohibit e-commerce sales by its distribution partners?

Yes, a supplier may restrict e-commerce sales by its distribution partners (especially distributors or franchisees) under German and EU antitrust law; however, suppliers may hardly impose a comprehensive prohibition on the online sale of goods (or services) because they are considered passive sales (cf. European Court of Justice, decision of 13 October 2011, *Pierre Fabre,* Case No. C-439/09, reaffirmed in *Coty Germany*; paragraph 52 of the Guidelines on Vertical Restraints of 10 May 2010; and paragraph 212 of the Guidelines on Vertical Restraints of 30 June 2022; see also the *Asics* decision of the German Federal Court of Justice (BGH) of 12 December 2017, which states that a general ban on the use of price comparison tools is void, though setting up guidelines for the use of those tools may be valid (see Rohrßen*, ZVertriebsR* 2018, 277–285 (282–283)).

Restrictions short of a total ban are commonplace, particularly the prohibition of sales via third-party online platforms (especially marketplaces), the ban of purely online sales by requiring the operation of brick-and-mortar shops (paragraph 52(c) of the Guidelines on Vertical Restraints of 10 May 2010) and setting quality criteria for internet sales regarding the domain name, the online store's appearance, the language, the services provided, etc (for details, see Rohrßen*, GRUR-Prax* 2018, 39–41 and *DB* 2018, 300–306). Such restrictions within a selective distribution system are allowed if they either meet the *Metro* criteria or can be exempt under the VBER, which requires that: the supplier's and the buyer's market shares do not exceed 30 per cent; and there are no hardcore restrictions listed in article 4 of the VBER or excluded restrictions under article 5 of the VBER. To be exempt under the VBER, the new hardcore restriction of article 4(e) VBER must be observed: the distribution agreement must not have as its object 'the prevention of the effective use of the internet by the buyer or its customers to sell the contract goods or services, as it restricts the territory into which or the customers to whom the contract goods or services may be sold (…)'. What, suppliers may explicitly impose, however, are other restrictions on online sales and restrictions on online advertising that do not have the object of preventing the use of an entire online advertising channel (for details: Rohrßen, VBER 2022: EU Competition Law for Vertical Agreements, Chapters 4.5 and 9).

A supplier may require that e-commerce sales by its distribution partners (and, new, also by their direct customers, cf. Rohrßen, VBER 2022, Chapter 4.2.4) are not resold outside the distribution partner's assigned territory, but only with respect to active sales into the exclusive territory or an exclusive customer group reserved to the supplier or another distribution partner, and only provided that the supplier's and the distribution partner's market shares do not exceed 30 per cent. Passive sales over the internet, that is, upon unsolicited requests from individual customers, can, in principle, not be restricted.

An alternative is to use commercial agents or commission agents because they are, in principle, exempt from the competition law restrictions: 'Since the principal bears the commercial and financial risks related to the selling and purchasing of the contract goods and services all obligations imposed on the agent in relation to the contracts concluded and/or negotiated on behalf of the principal fall outside Article 101(1)' (paragraph 18 of the Guidelines on Vertical Restraints of 10 May 2010, now paragraph 30 of the Guidelines on Vertical Restraints of 30 June 2022).

A supplier may require reports of e-commerce sales in the same way that a supplier may require reports of any other sales from its distribution partner; however, care must be taken that this does not result in resale price maintenance. Invasion fees or similar amounts, regardless of how they are named (contractual penalties, liquidated damages, etc), may be stipulated in the distributorship agreement for any breach of contract for which the distributor is responsible, including active sales into territories exclusively reserved to the supplier or allocated to another distributor.

Law stated - 5 February 2024

21 May a distributor or agent restrict a supplier's sales through e-commerce intermediaries into the distribution partner's territory? May it require the supplier to obtain reports of such sales by territory and a payment of 'invasion fees' or similar amounts to the distribution partner?

A distributor or agent may restrict a supplier's sales through e-commerce intermediaries if this has been stipulated in the distribution agreement and only in the following cases:

- active sales into the exclusive territory or an exclusive customer group reserved to the (maximum five) exclusive distributor(s) or the supplier itself (this shared exclusivity of up to five exclusive distributors is new, the concept of exclusivity has been broadened by the VBER 2022, cf. Rohrßen, VBER 2022: EU Competition Law for Vertical Agreements (2023);
- sales to end users if the e-commerce intermediary operates at wholesale level;
- sales from members of a selective distribution system to unauthorised distributors in the system's territory; and
- selling components, supplied for incorporation, to customers who would use them to manufacture the same kinds of products (article 4(b) VBER), provided that each party's market share does not exceed 15 per cent on any relevant market affected.

Law stated - 5 February 2024

Refusal to deal

22 Under what circumstances may a supplier refuse to deal with particular customers? May a supplier restrict its distributor's ability to deal with particular customers?

A supplier may refuse to deal with customers because of freedom of contract, unless restrictions by antitrust or anti-discrimination law apply.

A supplier may restrict its distributor's ability to deal with particular customers only if an exemption from antitrust law is given.

Law stated - 5 February 2024

Competition concerns

23 Under what circumstances might a distribution or agency agreement be deemed a reportable transaction under merger control rules and require clearance by the competition authority? What standards would be used to evaluate such a transaction?

Typically, German or European rules on merger control do not apply to the conclusion of a distribution or agency agreement because the agreement is a form of cooperation between companies that differs from a merger or acquisition. By way of exception, the conclusion of a distribution agreement may be subject to merger control under:

- German law if it is considered a 'combination of undertakings enabling one or several undertakings to exercise directly or indirectly a material competitive influence on another undertaking' (section 37 et seq GWB). However, this combination shall only exist if the parties are somehow affiliated; mere economic influence shall not suffice; and

- European law if it results in gaining direct or indirect control of the whole or parts of one or more other undertakings, including by contract (article 3(1b) of the Merger Regulation (Regulation (EC) 139/2004)). This control may also exist because of mere economic dependencies (which are to be measured on the circumstances of the case).

Law stated - 5 February 2024

24 Do your jurisdiction's antitrust or competition laws constrain the relationship between suppliers and their distribution partners in any other ways? How are any such laws enforced and by which agencies? Can private parties bring actions under antitrust or competition laws? What remedies are available?

Generally, agreements that aim at or result in restraints of competition are prohibited by antitrust law. Certain hardcore restrictions are generally prohibited regardless of the parties' market shares: for example, price-fixing, restricting the geographic areas or categories of customers and – under the new VBER – vertical agreements that have the purpose of preventing buyers or their customers from using the internet effectively for the online sale of goods and services remain unlawful hardcore restrictions (article 4(e) VBER). Other hardcore restrictions apply in particular to selective distribution (eg, no restriction of cross-supplies between distributors within a selective distribution system).

Unless there are hardcore restrictions, a safe harbour is provided by the De Minimis Notice and the VBER. However, if the market share of one of the parties exceeds 30 per cent, an agreement or concerted practice that restrains competition can only benefit from the efficiency defence of article 101(3) of the TFEU.

Antitrust law is mainly enforced by the authorities (the European Commission and the German Federal Cartel Office), especially through fines. However, it can also be enforced by private action, aiming to remove the infringement of antitrust law or claim damages (section 33 et seq GWB).

Also agreements concerning minimum purchase obligations are permissible in principle. Under the De Minimis Notice, a minimum purchase agreement may be exempted if the parties' combined market shares fall below 10 per cent or 15 per cent. The percentage is reduced to 5 per cent if the individual contract is part of comprehensive distribution agreements and the contract network covers at least 30 per cent of the relevant market. In addition, the minimum purchase obligation may be exempted pursuant to article 2 (1) VBER.

However, agreements on minimum purchase obligations are subject to the test of reasonableness (BGH, decision of 25 April 2001, Case No. VIII ZR 135/00; BGH, decision of 13 July 2004, Case No. KZR 10/03) and thus may be ineffective under German law of standard form contracts if they significantly exceed the distributor's resale opportunities. If a minimum purchase obligation is combined with a non-competition clause or an exclusive purchasing obligation, the manufacturer is only entitled to refuse orders from its authorised dealer for objective reasons.

Law stated - 5 February 2024

Parallel imports

25 Are there ways in which a distributor or agent can prevent parallel or 'grey market' imports into its territory of the supplier's products?

Distributors or agents cannot directly prevent parallel imports. Instead, they can only demand that their supplier use its rights, if existent, to prevent parallel imports. As a general rule, the trademark proprietor of an EU trademark is entitled to prevent all third parties that do not have his or her consent from using any sign that is identical or similar to the EU trademark in the course of trade, in relation to goods or services (article 9 of the Trademark Regulation (Regulation (EU) No. 2017/1001)). Such rights are exhausted 'in relation to goods which have been put on the market in the EEA under that trademark by the proprietor or with his consent' (article 15(1) of the Trademark Regulation). Trademark proprietors must present and prove only one of the elements of the infringement provided for under article 9 of the Trademark Regulation, and not the missing exhaustion (cf. Higher Regional Court of Munich, decision of 19 July 2018; Rohrßen and Tenkhoff, *GRUR-Prax* 2018, 578). Moreover, the rights are not exhausted if a legitimate reason to prohibit the grey market sales exists, namely because the use of the trademark threatens to damage the good's reputation (as decided by the Court of Justice of the European Union, *Dior/Evora*, Case No. C-337/95). In recent years, a court decision confirmed that this is especially true for the image of brands that have a luxury and prestige character, as also reflected in how they are advertised. The right to prevent such sales is, however, limited to cases with 'a risk of damage to the reputation', especially where the trademark used by the reseller 'substantially damages' the trademark's reputation. The court found that the use of a distribution channel that did not comply with the selective distribution system caused damage to the reputation of the luxury cosmetics to be distributed, namely by presenting the products amid other very standard products for daily use, low-priced products and special deals, all of which did not require any need to give advice to the customers (Higher Regional Court of Düsseldorf, decision of 6 March 2018; for details, see Rohrßen and Tenkhoff*, GRUR-Prax* 2018, 235).

Law stated - 5 February 2024

Advertising

26 What restrictions exist on the ability of a supplier or distributor to advertise and market the products it sells? May a supplier pass all or part of its cost of advertising on to its distribution partners or require them to share in its cost of advertising?

When advertising and marketing products, the parties generally have to observe the Unfair Competition Act, avoid misleading advertising and adhere to the Ordinance obliging sellers to mark goods with prices, as well as further provisions that regulate market behaviour in the interest of market participants (eg, labelling of textiles or food products). The parties are free to agree on the cost of advertising.

Law stated - 5 February 2024

Intellectual property

27 How may a supplier safeguard its intellectual property from infringement by its distribution partners and by third parties? Are technology transfer agreements common?

A supplier may safeguard its intellectual propertyby registering its patents, trademarks, utility models and designs in the territory where the products shall be distributed now or in the future. Thus, the supplier can exert the respective rights in the case of infringement. In addition, a supplier may stipulate indemnity clauses in their distributor contracts to cushion the consequences of possible infringements.

Technology transfer agreements are common and governed by the Technology Transfer Block Exemption (Regulation (EU) No. 316/2014).

Law stated - 5 February 2024

Consumer protection

28 What consumer protection laws are relevant to a supplier or distributor?

Consumer protection laws apply at the end of the distribution chain. German statutory law grants a two-year warranty that products are free from defects from the moment of delivery. If a defect is detected during this period, the buyer can claim subsequent performance (ie, choosing between the remedy of the defect and the delivery of a new, defect-free product), a price reduction or withdrawal from the contract (all regardless of fault) and damages if the seller acted with fault (sections 437 and 280 et seq BGB). Although fault is generally assumed by law, the seller can exculpate itself, especially if it was not the manufacturer of the defective product. These consumer rights can neither be waived by the buyer nor contracted out by the supplier (sections 474 and 475 BGB).

If the product proves to be already defective when delivered, each seller within the distribution chain has a right of recourse against its own supplier (sections 445a, 445b and 478 BGB). To be able to enforce this right, the buyer (unless it is a consumer) must inspect the product at the time of delivery and inform the seller if any defect is detected (section 377 HGB).

In addition, special information duties towards consumers apply in the following cases:

- over-the-phone sales (section 312a(1) BGB);
- over-the-counter sales, except everyday sales (section 312a(2)2 BGB and article 246(2) Introductory Act to the Civil Code);
- e-commerce (section 312j BGB); and
- selling off-premises and distance contracts (section 312d BGB).

Statutory law also provides a limit to the fees that can be charged to a consumer for using certain means of payment, consumer hotlines, etc (section 312a(3–5) BGB). Finally,

the consumer has a right of withdrawal in cases of distance and off-premises contracts (sections 312g and 355 BGB).

These consumer rights are harmonised throughout the European Union because they were aligned by EU Directive 1999/44/EC on the sale of consumer goods and EU Directive 2011/83/EU on consumer rights. However, there are differences relating to whether certain rules also apply in business-to-business relationships (eg, as regards the seller's obligation to give customers the opportunity to identify and correct input errors before placing their electronic orders), among other things.

Law stated - 5 February 2024

Product recalls

29 Briefly describe any legal requirements regarding recalls of distributed products. May the distribution agreement delineate which party is responsible for carrying out and bearing the cost of a recall?

There are generally no specific requirements set by statute law in regard to product recalls. Instead, according to case law, manufacturers must keep their products under surveillance and, when detecting risks concerning legally protected goods (such as healthcare products), they must promptly adopt the necessary preventive or corrective measures. The extent and time of these measures depend particularly on the product concerned and on the extent of the possible damage (BGH, decision of 16 December 2008).

The distribution agreement can identify which party shall be responsible for a recall and the relevant costs. No specific limits apply to individual agreements; however, in court, standard business terms are strictly reviewed: they can be declared void and unenforceable if they are incompatible with essential statutory principles or entail an unreasonable disadvantage, if they limit essential contractual rights and duties or if they are surprising or ambiguous (sections 310(1), 307 and 305c BGB). Therefore, standard business terms should be drafted while taking into account who would typically be responsible for recalls and relevant costs, depending on the product (eg, whether it is ready-made).

Law stated - 5 February 2024

Warranties

30 To what extent may a supplier limit the warranties it provides to its distribution partners and to what extent can both limit the warranties provided to their downstream customers?

A supplier may limit the warranty rights granted by statutory law towards its distribution partners, subject to a few limits concerningindividual agreements. The agreements must not breach statutory prohibitions (section 134 BGB) and public policy (section 138 BGB). Further, they must not limit or exclude liability for wilful intent, fraudulently concealing defects (where a guarantee has been given) or product liability law (sections 202, 276,

444 and 639 BGB). If a consumer detects a defect in the product and the defect already existed upon the passing of risk to the distribution partner, a limitation of warranty can only be enforced if the supplier provides another compensation of equal value (section 478(2) BGB).

In standard business terms, statute law can hardly be derogated from, even in business-to-business contracts (sections 310 (1) and 307 BGB).

It is possible to:

- modify the details of subsequent performance (namely the time, place and number of attempts);
- exclude liability for slightly negligent breaches of non-cardinal duties; and
- limit liability for slightly negligent breaches of non-cardinal duties to the typical damages foreseeable at the conclusion of the contract.

The same applies to warranties provided to each downstream customer unless the latter is a consumer, as a consumer's statutory rights cannot be waived or contracted out.

Law stated - 5 February 2024

Data transfers

31 Are there restrictions on the exchange of information between a supplier and its distribution partners about the customers and end users of their products? Who owns such information and what data protection or privacy regulations are applicable?

The exchange of information about customers is restricted by the Federal Data Protection Act (BDSG), which implemented EU Directive 95/46/EC, repealed by Regulation (EU) No. 2016/679 (the General Data Protection Regulation (GDPR)). The collection, processing and use of information on customers are only allowed if permitted by law (eg, owing to the performance of a contract) or with the customer's consent (article 6 GDPR (formerly section 4 BDSG); see also section 51 BDSG). Details on commercial collection and data storage for the purpose of transfer are laid down in article 5 et seq of the GDPR (formerly section 28 et seq BDSG).

The owner of customer information, if contained in a database, is the person who produced the database, provided that its assembly, verification or presentation required a substantial qualitative or quantitative investment (section 87a et seq of the German Copyright Act).

Data transfer between the EEA and the United States can currently only take place on the basis of standard contractual clauses. Both the Safe Harbour Agreement and the subsequent Privacy Shield Agreement have been declared void by the European Court of Justice *Schrems* and *Schrems II* decisions (6 October 2015 and 16 July 2020). It is now recommended to save the data in the EEA. When this is not possible, companies must obtain the approval of the customers and employees affected to transfer the data to the United States. This can (only) be made by using standard contractual clauses which – according to the European Commission – offer sufficient safeguards on data protection

for the data to be transferred internationally. However, this approach is not free of any risk. Customers or employees having doubts about whether their data is really sufficiently secured could contact the competent local data protection authority, which could under certain circumstances prohibit data transfers.

Law stated - 5 February 2024

32 What requirements apply to suppliers and their distribution partners with respect to protecting the security of customer data they hold?

Whenever a supplier or its distribution partner acts as a controller or a processor of personal data, they must implement appropriate technical and organisational measures to ensure an appropriate level of data security. These measures include:

- the pseudonymisation and encryption of personal data;
- the ability to restore the availability and access to personal data in a timely manner in the event of a physical or technical incident; and
- a process for regularly testing, assessing and evaluating the effectiveness of technical and organisational measures for ensuring the security of the processing.

Both controllers and processors of data must also ensure that any natural person acting under their authority does not process the data, except on instruction from the controller or unless required by EU or national law (article 32 GDPR).

Law stated - 5 February 2024

Employment issues

33 May a supplier approve or reject the individuals who manage the distribution partner's business, or terminate the relationship if not satisfied with the management?

The distribution partner is, in principle, free to decide which individuals to employ in order to manage the distribution partner's business unless the parties have agreed on a veto right for the supplier, in particular where if the agent or distributor has to render the services in person.

A supplier may terminate the relationship with notice (if the agreement is of an indefinite term, or agreed), or without notice, but for cause. However, termination for cause requires a more concrete cause than dissatisfaction with the management (unless individually agreed). It may suffice if culpable mismanagement has resulted in a strong decrease in turnover.

Law stated - 5 February 2024

34 Are there circumstances under which a distributor or agent, or its employees, would be treated as an employee of the supplier, and what are the consequences of such

treatment? How can a supplier protect against responsibility for potential violations of labour and employment laws by its distribution partners?

An agent may be considered a supplier's employee if the agent is not independent (ie, if he or she performs work that is subject to instructions and determined by the supplier). An agent acts independently if, based on the contractual framework and tasks, he or she freely organises his or her working time and activities (section 84(1)2 HGB). This also holds true – mutatis mutandis – for other types of distribution partners, especially distributors and franchisees.

If the sales intermediaries are classified as employees, they will be entitled to:

- employee protection, entailing, for example, a limited right of termination under the Dismissal Protection Act;
- continued payment of salary during public holidays, sick leave and holidays;
- minimum wage (in accordance with the Minimum Wage Act of 11 August 2014); and
- exclusive competence of labour courts if the employee has, over the previous six months of working activity, earned an average monthly salary not exceeding €1,000.

If the workers are classified as employees, the suppliers will also have to:

- pay social security contributions;
- pay income tax on salary; and
- adhere to worker participation and compliance with collective bargaining agreements, if applicable.

A supplier generally does not need to protect against responsibility for potential violations of labour and employment laws because the supplier is not required to respond to those violations unless it has contributed to them. However, the supplier can advise the distribution partner in the distribution agreement of the partner's sole responsibility.

Law stated - 5 February 2024

Commission payments

35 | Is the payment of commission to a commercial agent regulated?

Yes, the agent has a right to:

- 'del credere commission' if the agent assumes liability for fulfilment of contracts procured by the agent (section 86b HGB);
- follow-up commission (section 87 (1) alt 2 HGB) for intensified, existing customers to protect the commercial agent from direct business of the principal and to reward the advertising of regular customers. The prerequisite is repeat orders of the same type by the customer recruited by the agent. Such commission claim may, however,

be contracted out, cf. European Court of Justice, decision of 13 October 2022, Case No. C-64/21 (*Rigall/Bank Handlowy*), cf. Rohrßen, *ZVertriebsR* 2023, Issue 1;

- commission as soon as the principal has executed the transaction (section 87a (1) HGB);
- calculation of commission on a monthly basis, which can be extended to a maximum of three months (section 87c (1) HGB); and
- commission irrespective of delivery and payment, unless the principal is not liable for such failure (section 87a (3) HGB).

The agent also has a right to request information, statements of account, an excerpt from the books and inspection of the business records or analogous documents by an auditor (section 87c HGB). The statement of accounts must enable the commercial agent to identify the individual transactions subject to commission and to verify the calculation of the commission, hence the statement must list which transactions were carried out with which customers in the respective accounting period, what the relevant transaction value (usually: price of goods) is and what commission amount the commercial agent is entitled to claim.

An entitlement to a book extract also exists with regard to those transactions for which it is doubtful whether the commercial agent is entitled to commission, but not insofar as these are transactions for which there is no doubt that commission is not payable (Higher Regional Court Hamm, decision of 13 December 2021, Case No. 18 U 31/21, juris-para 82; Thume/Rohrßen, in: Röhricht et al., HGB, 6th ed. 2023, § 87c para. 16).

The right to inspect the business records in accordance with section 87c (4) HGB extends to the entire (already existing) business records of the principal with relation to the payment claims of the commercial agent under the agency agreement covered by section 87c HGB, including electronically maintained business records. However, this does not give rise to a claim against the principal for the creation or external procurement of additional, unavailable documents. Rather, the right to inspect the books is limited to those documents that are held by the principal (Higher Regional Court Frankfurt, decision of 14 April 2022, Case No. 26 Sch 1/22, juris-paras 137 et seq).

The above-listed rules are mandatory and cannot be waived or contracted out (with the exception of follow-up commission, section 87 (1) alt 2 HGB). Further details on the payment of commission (unless otherwise agreed) are provided under section 86b et seq of the HGB. According to section 87b (2) HGB commission shall be calculated on the basis of the remuneration payable by the third party or the principal. However, this provision is dispositive, meaning that the amount of commission can also be made dependent on the quantity of goods sold (Higher Regional Court Hamm, decision of 15 February 2021, Case No. 18 U 60/20, juris-paras. 75 f.).

If a contract procured by the commercial agent is partially not executed, the principal's obligation to pay the commission depends on the concept of 'reason for which the principal is to blame' as laid down in article 11 of the Commercial Agency Directive and interpreted by the European Court of Justice (decision of 17 May 2017,*ERGO Poist'ovňa*). In that case, the commercial agent may be required to refund a part of his or her commission, under the conditions that the partial amount is proportionate to the extent to which the contract has

not been executed and that the non-execution is not due to a reason for which the principal is to blame (for details, see Franke and Rohrßen*, IWRZ*2018, 107–111).

Agreements on commission are not subject to the strict review under German law of standard form contracts, as according to section 307(3)(1) BGB, the test of reasonableness applies only to provisions in standard business terms on the basis of which arrangements deviating from legal provisions, or arrangements supplementing those legal provisions, are agreed. Agreements on the direct object of the main service, on the other hand, as well as agreements on the remuneration to be paid by the other party, in particular insofar as they relate to its amount, are not subject to review in accordance with section 307 (1) sentence 1, (2) BGB (Higher Regional Court of Hamm, decision of 15 February 2021, Case No. 18 U 60/20, juris-para 72 and 75 et seq). However, this only applies to provisions that determine the type, scope and quality of the performance owed. Clauses that change, shape or modify the main performance promise in deviation from the law or the performance owed in good faith, on the other hand, are subject to review (BGH, decision of 9 April 2014, Case No. VIII ZR 404/12, NJW 2014, 2269 paragraph 43 et seq), including so-called ancillary price agreements.

Law stated - 5 February 2024

Good faith and fair dealing

36 | What good faith and fair dealing requirements apply to distribution relationships?

The parties to distribution relationships have to safeguard each other's interests (sections 86, 86a and 90 HGB and section 242 BGB). Actually, the duty to safeguard interests under section 86 HGB is essential and mandatory for the agency agreement (for a list of mandatory commercial agency rules, see Rohrßen, *ZVertriebsR* 2023, issue 1).

In particular, the commercial agent is obliged to:

- check customers' creditworthiness;
- promptly inform the supplier about any business procured;
- keep any information obtained during his or her activity confidential; and
- refrain from acting for the supplier's competitors.

Similar obligations, except non-competition, also apply to distributors, commission agents and franchisees (cf. the overview by Thume/Rohrßen, in: Röhricht et al, HGB, 6th ed. 2023, § 84 paragraph 40).

The supplier is obliged to assist and take care of its distribution partner subject, however, to the supplier's economic freedom.

Accordingly, commercial agents must refrain from any competition that is likely to harm the interests of their principal in accordance with section 86 (1) HGB. If they violate this provision, they are liable for damages (cf. eg, Regional Labor Court Berlin-Brandenburg, decision of 1 December 2022, Case No. 21 Sa 390/22, juris-paragraphs 130, 143 et seq, 152-157, 167, 172).

The commercial agent's duty to safeguard the interests of the principal pursuant to section 86 (1) HGH gives rise to a right to issue instructions. If the commercial agent acts on the basis of such instructions, he is acting in the interests of a third party and not independently, so that this activity is not subject to the prohibition of extrajudicial legal advice under section 3 Act on Out-of-Court Legal Services [RDG] (Higher Regional Court Dresden, decision of 26 April 2022, Case No. 14 U 2489/21).

The principal, on the other hand, must fulfil its obligations towards the commercial agent in accordance with section 86a HGB. This also includes the obligation to provide the commercial agent with the documentation required for the performance of his activities. The term 'documentation' is to be understood broadly and, according to the BGH, also includes a POS system (BGH, decision of 17 November 2016, Case No. VII ZR 6/16).

However, general business costs, such as office equipment, are to be borne by the commercial agent itself.
Cashless payment options are also not to be provided by the principal as a required document, as the commercial agent can procure this payment service him or herself and thus continue to be able to carry out his activities (Berlin Court of Appeal, decision of 17 March 2022, Case No. 2 U 4/20, juris-para 18 et seq).

Law stated - 5 February 2024

Registration of agreements

37 Are there laws requiring that distribution agreements or intellectual property licence agreements be registered with or approved by any government agency?

No.

Law stated - 5 February 2024

Anti-corruption rules

38 To what extent are anti-bribery or anti-corruption laws applicable to relationships between suppliers and their distribution partners?

German anti-bribery and anti-corruption laws may also apply to the relationship between a supplier and its distribution partner, especially to practices such as:

- taking and giving bribes in commercial practice;
- restricting competition in the context of public invitations to tender; and
- taking or giving bribes to public officials, including inducing or assisting with those acts (section 298 et seq and section 333 et seq of the German Criminal Code).

Any underlying agreement to such practice can and typically will be declared void as being in breach of law (section 138 BGB); for example, an agency agreement that aims to bring

about a bribe agreement with public officials (Higher Regional Court of Stuttgart, decision of 10 February 2010).

Law stated - 5 February 2024

Prohibited and mandatory contractual provisions

39 Are there any other restrictions on provisions in distribution contracts or limitations on their enforceability? Are there any mandatory provisions? Are there any provisions that local law will deem included even if absent?

No, except for mandatory provisions provided by the relevant statutes and case law. The respective statutory law will apply even if the contract is silent.

Law stated - 5 February 2024

GOVERNING LAW AND CHOICE OF FORUM

Choice of law

40 Are there restrictions on the parties' contractual choice of a country's law to govern a distribution contract?

The parties are generally free to choose the law governing their contract (article 3 of the Rome I Regulation). However, if all elements relevant to the choice of law at the time of the choice are located in a country other than that of the chosen law, the choice of the parties shall not prejudice the application of provisions that cannot be derogated from by agreement (article 3(3) and (4) of the Rome I Regulation).

Further, overriding mandatory provisions of the law of the forum cannot be excluded by choosing another law. Similarly, the courts may also apply overriding mandatory provisions of the country where the contractual obligations have to be performed (article 9 of the Rome I Regulation). One typical example of laws that the courts qualify as overriding mandatory rules within distribution agreements is the provisions of commercial agency law because they are based on the EU Commercial Agency Directive of 1986. Accordingly, the agent's claim for goodwill indemnity cannot be waived or contracted out when the agent acts within the European Union. This is true even if the parties choose the law of a non-EU country, as decided by the European Court of Justice on 9 November 2000 (*Ingmar*)- on the former Rome Convention on Law Applicable to Contractual Obligations of 1980. Arguments for applying the same principles under the Rome I Regulation exist; however, a clear confirmation by the courts has yet to be reached.

Law stated - 5 February 2024

Choice of forum

41 Are there restrictions on the parties' contractual choice of courts or arbitration tribunals, whether within or outside your jurisdiction, to resolve contractual disputes?

The parties are generally free to choose a court, especially if:

- the other party is domiciled outside Germany in an EU member state, and the parties have agreed that a court or the courts of an EU member state shall have jurisdiction (article 25 of the Brussels Ia Regulation);
- the other party is domiciled in Iceland, Switzerland or Norway, and the parties have agreed that the courts of one of these states or of Germany will take jurisdiction over any disputes (article 23 of the Lugano II Convention); or
- both parties are merchants, legal persons under public law or special assets under public law, or the other party is domiciled outside Germany (section 38 of the Code of Civil Procedure (ZPO)).

As an alternative, the parties may choose arbitration (section 1029 et seq ZPO, article 1(2)d of the Brussels Ia Regulation and article 1(2)d of the Lugano II Convention). However, the choice of court proceedings or arbitration can hardly avoid overriding mandatory provisions. This has been confirmed by the BGH (decision of 5 September 2012, following a decision of the Higher Regional Court of Munich of 17 May 2006).

Law stated - 5 February 2024

Litigation

42 What courts, procedures and remedies are available to suppliers and distribution partners to resolve disputes? Are foreign businesses restricted in their ability to make use of these courts and procedures? Can they expect fair treatment? To what extent can a litigant require disclosure of documents or testimony from an adverse party? What are the advantages and disadvantages to a foreign business of resolving disputes in your country's courts?

Suppliers and distribution intermediaries can make use of all means of dispute resolution, including out-of-court negotiation, mediation, arbitration or litigation. Restrictions exist only insofar as the application of overriding mandatory provisions cannot be excluded by means of dispute resolution. Fair treatment in German courts is to be expected because the judges are independent and impartial, well trained and determined beforehand, and the parties are entitled to due process under the Constitution (articles 101 and 103). The advantages of resolving disputes in Germany are, inter alia, that court rulings are quite foreseeable and trials are fairly quick (10.4 months on average in the district courts, according to the latest statistics of the Federal Office of Justice). Moreover, more and more courts are establishing English-speaking court bodies, such as the Chamber for International Commercial Disputes of the Landgericht Frankfurt am Main; others have, for example, been installed in Hamburg and Cologne. The Chamber shall be an attractive forum for cross-border disputes of English-speaking parties, providing the benefit from Germany's reliable public dispute resolution mechanisms at no extra cost.

Law stated - 5 February 2024

Alternative dispute resolution

43 Will an agreement to mediate or arbitrate disputes be enforced in your jurisdiction? Are there any limitations on the terms of an agreement to arbitrate? What are the advantages and disadvantages for a foreign business of resolving disputes by arbitration in a dispute with a business partner in your country?

Yes, an agreement to mediate or arbitrate disputes will be enforced in Germany (section 1029 et seq and section 278a ZPO). Arbitration may be disadvantageous if only small sums are concerned (the costs for German courts are typically lower than the costs for arbitration if the amount in dispute is less than €5 million).

Limitations on an agreement to arbitrate with respect to the arbitration tribunal, the location of the arbitration or the language of the arbitration do not exist.

Typical advantages of arbitration are that proceedings are confidential and lead to a final decision without the opportunity to appeal, and the award is enforceable in far more countries than court judgments (because of the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards).

Law stated - 5 February 2024

UPDATE AND TRENDS

Key developments

44 Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? Are there any other current developments or trends that should be noted?

Current developments especially concern the new EU competition rules, new decisions on franchising, dual distribution and the rising supply chain and product compliance rules.

New EU Competition Law Rules for Distribution – Revised Vertical Block Exemption Regulation

In July 2021, the European Commission published the proposed draft revised VBER and the draft revised Vertical Guidelines, which have been further amended and put into force on 1 June 2022. The new VBER and guidelines replace the current VBER, which came into force in 2010 and expired on 31 May 2022. According to the new VBER, the basic framework remains unchanged: it exempts from prohibition agreements that (1) are concluded vertically (= between non-competitors); (2) between companies with market shares up to a maximum of 30 per cent; and (3) do not contain hardcore restrictions. The prohibited hardcore restrictions continue to include resale price maintenance.

However, as set out in the background note accompanying the two drafts, significant changes were introduced to:

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readjust the safe harbour provided by the VBER to its intended scope, as regards the four areas of dual distribution, parity obligations, active sales restrictions, and certain indirect measures restricting online sales;

- provide stakeholders with up-to-date guidance for a business environment reshaped by the growth of e-commerce and online platforms and ensuring a more harmonised application of the vertical rules across the EU; and
- reduce compliance costs for businesses, notably small and medium-sized enterprises, by simplifying and clarifying certain provisions perceived as particularly complex and difficult to implement.

For details, see Rohrßen, VBER 2022, EU Competition Law for Vertical Agreements (2023).

Franchising

From a franchise contractual perspective, a judgment by the Higher Regional Court Munich (dated 7 November 2019, Case No. 29 U 4165/18 Kart) has found that franchisors may advertise products to be sold by the outlets at low prices as long as the franchisees are not prevented from charging lower prices than those advertised; in this situation, the low prices only have the effect of a permissible maximum price-fixing in relation to the franchisees.

Moreover, the same court decision promotes reviewing clauses regarding advertising fees because the c-https://competition-policy.ec.europa.eu/system/files/2023-07/2023_revised_horizontal_guidelines_en.pdfourt established that the franchisor is likely subject to a fiduciary duty regarding the capital earned by advertising fees if the respective advertising fee clause stipulates that the franchisor becomes active for its franchise system. Accordingly, the franchisor's use of an advertising contribution by the franchisor contrary to this clause may breach the franchise contract. However, such breach does not generally give rise to a contractual or legal claim for the franchisee to prohibit such other use.

Finally, another recent judgment (Higher Regional Court of Jena, 22 April 2020, Case No. 2 U 287/18) sets out the principles for price adjustment clauses applicable to continuing obligations. As the franchisor is generally obliged to develop its system or concept, franchise agreements regularly contain clauses on system adaptation as well as corresponding price adjustment clauses. Since franchise agreements are aimed at maintaining the uniformity of the respective system, they are by their very nature to be regarded as general terms and conditions and are thus subject to the strict provisions on general terms and conditions pursuant to sections 307 et seq BGB. To comply with these provisions, price adjustment clauses should especially be formulated as clearly and understandably as possible, laying down the preconditions and the extent of a potential price adjustment. For details, see Rohrßen, *ZVertriebsR* 2021, 31 et seq.

Dual distribution – new rules on information exchange

There is an ongoing trend in distribution to move from single or multichannel distribution to cross-channel or even omnichannel distribution. This trend has had a further boost owing to the restrictions implemented as a result of the covid-19 pandemic. The trend combines all channels to provide customers with a seamless shopping experience, integrating services such as click and collect, click and reserve, click and deliver, and in-store touchpoints.

To avoid friction within the distribution system, omnichannel distribution strategies require clear communication as well as stipulation between the supplier and its distribution partners regarding the use of online stores, social media, local mobile marketing and the coordination and integration of all these services (especially because restrictions on online sales have been under scrutiny by the antitrust authorities in recent years). As far as dual distribution (manufacturers selling directly to end customers and through sales intermediaries) is concerned, the VBER 2022, the Vertical Guidelines and the revised Horizontal Guidelines regulate the information exhcange in dual distribution more in detail, recognizing that a certain degree of exchange is characteristic for competitive markets. To be exempt under the VBER, the exchange of information between a supplier and its buyer shall be (i) directly related to the implementation of the vertical agreement and (ii) necessary to improve the production or distribution of the contract goods or services (for details and examples, cf. Rohrßen, VBER 2022: EU Competition Law for Vertical Agreements, Chapter 2.4.3 and Chapter 8).

Regulatory is rising – new regulatory requirements under EU law to be observed when distribution products

New regulatory frameworks, particularly under EU law, are reshaping the landscape of product distribution and compliance requirements.

The Supply Chain Due Diligence Act, effective since 1 January 2023, mandates compliance for German companies with a workforce of 1,000 employees since 1 January 2024. Affected entities are compelled to revamp their operational strategies, particularly focusing on procurement practices, to align with the Act's provisions.

Crucially, these companies must proactively mitigate potential violations of human rights and environmental obligations across their operations and supply chains. This involves instituting robust risk management systems tailored to departments like procurement, compliance and sustainability. Moreover, they must conduct regular risk analyses to identify any lapses in compliance, with a focus on human rights and environmental concerns.

Policy formulation is pivotal, as companies are required to articulate their approach to human rights and environmental stewardship. This policy statement must delineate compliance procedures, identify specific risks, and outline expectations from both employees and suppliers.

Preventive and remedial measures constitute another key aspect of compliance efforts. Based on the outcomes of risk analyses, companies must implement or review preventive measures such as supplier selection criteria, codes of conduct, training programmes and sustainable procurement strategies.

Furthermore, the establishment of a formal complaints procedure is mandated to facilitate the reporting of human rights violations or risks thereof. Comprehensive documentation

and reporting are imperative, with companies obligated to maintain records of their compliance efforts and publish annual reports submitted to the relevant regulatory authority.

Non-compliance with the Supply Chain Due Diligence Act carries significant penalties. The competent authority, the Federal Office of Economics and Export Control, can impose fines of up to €8 million for breaches of due diligence and reporting obligations. For companies with an average annual turnover exceeding €400 million, fines may amount to 2 per cent of their turnover if they fail to implement remedial actions.

Moreover, companies risk exclusion from public tenders for up to three years, emphasising the importance of strict adherence to the Act's provisions. Notably, compliance is essential for all entities along the supply chain, not just the primary company or direct suppliers.

In addition to the Supply Chain Due Diligence Act, distributors face further regulatory challenges arising from recent EU product regulations. These include the EU Battery Regulation, Product Safety Regulation (cf. *Spiegel*, ZVertriebsR 2023, 71-80),Machinery Regulation, the future Product Liability Directive and the Ecodesign Regulation, each imposing unique obligations on economic operators across the supply chain.

Given the multifaceted nature of these regulatory developments, staying abreast of the latest legal requirements is paramount to ensure a compliant and functioning distribution set-up.

Law stated - 5 February 2024

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Summary

GOVERNING LAW AND CHOICE OF FORUM

UPDATE AND TRENDS

DIRECT DISTRIBUTION

Ownership structures

1 | May a foreign supplier establish its own entity to import and distribute its products in your jurisdiction?

Yes, a foreign supplier can establish an entity in India for import and distribution, subject to compliance with the foreign exchange control regulations, namely the Foreign Exchange Management Act 1991 and accompanying regulations and the prevailing Foreign Direct Investment Policy (the FDI Policy).

The FDI Policy prescribes, among other things, the types of business entities that may be established by a foreign party, the cap on foreign investments and the minimum investments that should be made by foreign parties. Foreign suppliers can acquire up to a 100 per cent stake in an Indian entity engaged in a wholesale cash-and-carry business, single-brand retail trading (SBRT), or an e-commerce marketplace platform business. However, foreign parties can acquire up to a 51 per cent stake, with government approval, in an Indian entity engaged in multi-brand retail trading (MBRT). The FDI Policy also prescribes several other compliance obligations for Indian entities with foreign ownership engaged in SBRT, MBRT, wholesale cash-and-carry business and e-commerce market platform business. For example, entities engaged in MBRT should ensure that at least 30 per cent of the value of products purchased should be sourced from India. Similarly, minimum sourcing conditions apply to the entities that are engaged in SBRT and where foreign investment is more than 51 per cent.

Law stated - 30 January 2024

2 | May a foreign supplier be a partial owner with a local company of the importer of its products?

Yes, a foreign supplier can be a partial owner in an Indian entity along with one or more local Indian parties.

Law stated - 30 January 2024

3 | What types of business entities are best suited for an importer owned by a foreign supplier? How are they formed? What laws govern them?

Foreign parties can set up a public or private limited company under the Companies Act 2013 for import and distribution of products in India. A private limited company is most suitable if the intent is to have only a few shareholders in the Indian entity.

The Companies Act 2013 is the primary legislation that regulates companies in India. The Companies Act regulates, among other things, incorporation of companies; management and administration of companies; duties and responsibilities of directors; corporate governance framework; issuance and transfer of shares and debentures; maintenance of books of account; and dissolution and winding up of companies.

The incorporation of a company in India involves several steps, such as: preparing by-laws for the proposed company; seeking approval for the name of the proposed company; and filing the by-laws with the Ministry of Corporate Affairs, along with several declarations and affidavits from the shareholders and the directors of the proposed company.

Law stated - 30 January 2024

Restrictions

4 Does your jurisdiction restrict foreign businesses from operating in the jurisdiction, or limit foreign investment in or ownership of domestic business entities?

Under the prevailing Foreign Direct Investment Policy, 100 per cent foreign ownership is permitted in Indian entities engaged in wholesale cash-and-carry business, SBRT and e-commerce market platform business. In the case of entities engaged in MBRT, up to 51 per cent foreign investment is possible with prior approval of the government of India.

Law stated - 30 January 2024

Equity interests

5 May the foreign supplier own an equity interest in the local entity that distributes its products?

Yes, a foreign supplier can hold an equity interest in the local distributing entity, subject to conditions that are prescribed in the FDI Policy. These conditions may relate to the maximum permitted foreign ownership in the local entity, the minimum value of foreign investments that should be made in the Indian entity, government approvals for making foreign investments, and other performance conditions that may be applicable to the local entity with foreign shareholding.

Law stated - 30 January 2024

Tax considerations

6 What are the tax considerations for foreign suppliers and for the formation of an importer owned by a foreign supplier? What taxes are applicable to foreign businesses and individuals that operate in your jurisdiction or own interests in local businesses?

Various taxes may be applicable, including income tax (applicable on profits and income), goods and services tax (applicable on sale of goods and services provided) and customs duty (on import of products into India). Withholding tax may apply for payments made by an Indian entity to a foreign supplier.

Law stated - 30 January 2024

LOCAL DISTRIBUTORS AND COMMERCIAL AGENTS

Distribution relationships

7 What alternative distribution relationships are available to a supplier?

The most common structure used by a foreign supplier is a simple distribution arrangement for the entire country or a specific region. Franchising is used for concepts or systems being licensed and is gaining popularity. Trademark licensing is mostly used when the intention is to produce goods in India for sale using the supplier's trademark only. Joint ventures are most commonly used when foreign and Indian parties combine to use the foreign partner's technology to manufacture goods in India, either for domestic sales or for exports.

Law stated - 30 January 2024

Legislation and regulators

8 What laws and government agencies regulate the relationship between a supplier and its distributor, agent or other representative? Are there industry self-regulatory constraints or other restrictions that may govern the distribution relationship?

The relationship between a supplier and its distributor, agent or other representative is contractual in nature. The Indian Contract Act 1872 is the primary legislation on such contracts. The Sale of Goods Act 1930, which provides for certain implied conditions and warranties for sale and purchase of goods, may also apply. Additionally, the Competition Act 2002, the Income-tax Act 1961, the Foreign Exchange Management Act 1999 and the Trade Marks Act 1999 are other important pieces of legislation that regulate distribution and agency arrangements.

There are no government agencies that regulate the relationship between a supplier and its distributor or agent or other representative. Lastly, there are limited industry self-regulatory bodies that may impact the distribution or agency relationship.

Law stated - 30 January 2024

Contract termination

9 Are there any restrictions on a supplier's right to terminate a distribution relationship without cause if permitted by contract? Is any specific cause required to terminate a distribution relationship? Do the answers differ for a decision not to renew the distribution relationship when the contract term expires?

The relationship between a supplier and its distributor is contractual in nature. The law does not restrict a supplier from terminating a distribution contract without cause where such termination is permitted under the contract. Similarly, the renewal or non-renewal of a contract will also be governed by the contract between the parties.

Law stated - 30 January 2024

10 Is any mandatory compensation or indemnity required to be paid in the event of a termination without cause or otherwise?

There is no statutory requirement for a party terminating the contract, with or without cause, to pay any compensation or indemnify the non-terminating party, unless such termination itself is unlawful under the terms of the contract, resulting in a loss to the non-terminating party. Compensation or indemnity payable to the non-terminating party would depend on the contractual terms. In the absence of any understanding, courts are free to determine the quantum of compensation payable by the terminating party to the non-terminating party.

Law stated - 30 January 2024

Transfer of rights or ownership

11 Will your jurisdiction enforce a distribution contract provision prohibiting or restricting the transfer of the distribution rights to the supplier's products, all or part of the ownership of the distributor or agent, or the distributor or agent's business to a third party?

Yes, such provisions are generally enforceable. However, a restriction on the transfer of ownership of the distributor or agent, or their respective businesses to a third party may not be enforceable where the courts are likely to arrive at a determination that such restrictive covenants operate in restraint of trade or are unreasonable.

Law stated - 30 January 2024

REGULATION OF THE DISTRIBUTION RELATIONSHIP

Confidentiality agreements

12 Are there limitations on the extent to which your jurisdiction will enforce confidentiality provisions in distribution agreements?

Confidentiality provisions are generally enforceable, both during the term and post termination of the contract. Confidentiality covenants must be reasonable in time and scope, and should not be an artefact to restrict a distributor from dealing with its supplier's competitors.

Law stated - 30 January 2024

Competing products

13 Are restrictions on the distribution of competing products in distribution agreements enforceable, either during the term of the relationship or afterwards?

In accordance with the Competition Act 2002, restrictions on the distribution of competing products during the term of a contract may be enforceable, provided they do not cause any appreciable adverse effect on the competition (AAEC) in India.

Although the Competition Act 2002 does not define an AAEC, it specifies the following factors that shall be considered by the Competition Commission of India (CCI) when determining the presence of an AAEC, namely:

- creation of barriers to new entrants in the market;
- driving existing competitors out of the market;
- foreclosure of competition by hindering entry into the market;
- accrual of benefits to consumers;
- improvements in production or distribution of goods, or provision of services; and
- promotion of technical, scientific and economic development by means of production or distribution of goods, or provision of services.

Furthermore, such restrictions should not be imposed by a supplier as an abuse of its dominant position. Dominant position means a position of strength enjoyed by an enterprise, in the relevant market in India that enables it to operate independently of competitive forces prevailing in the relevant market or affect its competitors or consumers or the relevant market in its favour.

Law stated - 30 January 2024

Prices

14 May a supplier control the prices at which its distribution partner resells its products? If not, how are these restrictions enforced?

In accordance with the Competition Act, any agreement for resale price maintenance among enterprises or persons at different stages or levels of the production chain in different markets shall be void if such resale price maintenance causes or is likely to cause an AAEC in India. Resale price maintenance involves the fixation of a minimum price of products, below which the products cannot be sold.

A supplier may control the prices at which its distribution partner resells its products, provided that such control in prices by the supplier does not have an AAEC in India.

Law stated - 30 January 2024

15 May a supplier influence resale prices in other ways, such as suggesting resale prices, establishing a minimum advertised price policy, announcing it will not deal with customers who do not follow its pricing policy, or otherwise?

Although a supplier may influence resale prices, any arrangement or artefact by the supplier for resale price maintenance (ie, fixation of minimum price of products) shall be void if the resale price maintenance causes or is likely to cause an AAEC in India.

Law stated - 30 January 2024

16 | May a distribution contract specify that the supplier's price to the distributor will be no higher than its lowest price to other customers?

Yes.

Law stated - 30 January 2024

17 | Are there restrictions on a seller's ability to charge different prices to different customers, based on location, type of customer, quantities purchased, or otherwise?

Legally, sellers are not restricted from charging different prices to different customers based on location, type of customer, quantities purchased or any other parameters.

Law stated - 30 January 2024

Geographic and customer restrictions

18 | May a supplier restrict the geographic areas or categories of customers to which its distribution partner resells? Are exclusive territories permitted? Is there a distinction between active sales efforts and passive sales that are not actively solicited, and how are those terms defined?

A supplier may restrict the geographic areas, territory or categories of customers to which its distribution partner resells, provided that the restriction does not cause an AAEC in India. The applicable law does not make any distinction between active sales efforts or passive sales for determining market restrictions.

Law stated - 30 January 2024

19 | If geographic and customer restrictions are prohibited, how is this enforced?

In accordance with the Competition Act, agreements that limit, restrict, or allocate any area or market for sale of products will be considered void if they cause or are likely to cause an AAEC in India. Similarly, an agreement restricting the customers to whom products may be sold will be void if it causes or is likely to cause an AAEC in India.

Law stated - 30 January 2024

Online sales

20 | May a supplier restrict or prohibit e-commerce sales by its distribution partners?

In accordance with the Competition Act, a supplier may restrict or prohibit e-commerce sales by its distribution partners, and levy an invasion fee for violation of such restrictive covenants, provided that such restriction or prohibition does not cause or is not likely to cause an AAEC in India.

Law stated - 30 January 2024

21 | May a distributor or agent restrict a supplier's sales through e-commerce intermediaries into the distribution partner's territory? May it require the supplier to obtain reports of such sales by territory and a payment of 'invasion fees' or similar amounts to the distribution partner?

Yes, a distributor or agent and its supplier can agree in a contract that the supplier will not sell through e-commerce intermediaries into the distribution partner's territory, and an invasion fee for violation of such restrictive covenants can be levied.

Law stated - 30 January 2024

Refusal to deal

22 | Under what circumstances may a supplier refuse to deal with particular customers? May a supplier restrict its distributor's ability to deal with particular customers?

There are no statutory restrictions on a supplier's ability to refuse to deal with customers. However, a contract between a supplier and its distributor placing restrictions on the distributor's ability to deal with particular customers will be void if the restrictions will cause or are likely to cause an AAEC in India.

Law stated - 30 January 2024

Competition concerns

23 | Under what circumstances might a distribution or agency agreement be deemed a reportable transaction under merger control rules and require clearance by the competition authority? What standards would be used to evaluate such a transaction?

Under the Competition Act, distribution or agency arrangements are not reportable transactions and do not require any clearance from the CCI or any other authority.

Law stated - 30 January 2024

24 | Do your jurisdiction's antitrust or competition laws constrain the relationship between suppliers and their distribution partners in any other ways? How are any

such laws enforced and by which agencies? Can private parties bring actions under antitrust or competition laws? What remedies are available?

The Competition Act broadly stipulates that any agreement among enterprises or persons at different stages or levels of the production or supply chain in different markets that imposes any conditions that may cause an AAEC in India shall be void. Such agreements may include tie-in arrangements, exclusive supply agreements, exclusive distribution agreements, arrangements for refusal to deal, and arrangements for resale price maintenance. The restrictive covenants in agreements among enterprises or persons at different stages or levels of production or supply chain are not per se void unless they have or may have an AAEC in India.

Additionally, the Competition Act prohibits abuse of dominance by any business entity, including a supplier, that enjoys a position of strength or dominance in the relevant product or service market. Certain practices by a dominant entity, including predatory pricing and denial of market access, are prohibited.

In accordance with the Competition Act, the CCI, on its own motion or based on information received from any person, including the consumer or distributor, or on a reference made to it by the central or state government or any statutory authority, may initiate an inquiry into any alleged violation of the Competition Act. If a complaint is made against the activity of a supplier as being anticompetitive, the CCI will consider each case on its merits. An appeal can be made to the National Company Law Appellate Tribunal and thereafter to the Supreme Court of India in relation to any decision made by the CCI.

The Competition Act also provides that non-parties to a contract, including consumers can approach the CCI and obtain declaratory orders and injunctions. However, compensation claims must be brought before the National Company Law Appellate Tribunal.

In the case of a conviction under the Competition Act, the CCI is empowered to pass any or all of the following orders:

- direct the concerned undertakings to discontinue and not to re-enter the agreement or discontinue the abuse of the dominant position;
- impose a penalty, which may be up to 10 per cent of the average turnover for the three preceding financial years of the concerned undertakings;
- direct that the agreement shall stand modified to the extent and manner as may be specified by the CCI; and
- pass such other orders as it may deem fit.

The CCI is empowered to issue interim orders, temporarily restraining a party from carrying on an anticompetitive act, where it is satisfied that the anticompetitive act has been committed or is about to be committed.

Law stated - 30 January 2024

Parallel imports

25

Are there ways in which a distributor or agent can prevent parallel or 'grey market' imports into its territory of the supplier's products?

The Patents Act 1970 allows parallel imports in relation to patents, and the Trade Marks Act 1999 provides for the principle of international exhaustion of rights, which suggests that parallel imports are allowed if the goods are genuine and have not been materially altered or impaired. However, there are certain exceptions to parallel imports, most notably in the case of parallel imports of products whose designs are protected under the Design Act 2000 and in the case of goods bearing a false trademark or a false trade description. The distributor or agent may cite these exceptions in a genuine case to prevent parallel imports of the supplier's products in its designated territory.

In general, the interpretation of parallel imports is ambiguous in India and is a subject that has been highly debated in various judicial forums without definite conclusions regarding its legality. Generally, no action can be taken to restrain the parallel import of products that are protected under the Patents Act or the Trademarks Act, unless it can be proved that the products are counterfeit or fake, or materially altered or impaired. With regard to articles whose design is protected under the Designs Act, parallel imports of even genuine goods are presently prohibited. However, to enforce this exception, the product design should have registration in India in accordance with the Designs Act.

Law stated - 30 January 2024

Advertising

26 What restrictions exist on the ability of a supplier or distributor to advertise and market the products it sells? May a supplier pass all or part of its cost of advertising on to its distribution partners or require them to share in its cost of advertising?

There is no uniform law or statutory body regulating the advertising industry. Therefore, a supplier or distributor must comply with industry-specific laws, which may restrict or prescribe the manner in which an advertisement should be published. These include the Consumer Protection Act 2019, which prohibits false or misleading advertisements that are prejudicial to the interest of any consumer or are in contravention of consumer rights. The Food Safety and Standards Act 2006 prescribes that an advertisement relating to the standard, quality, quantity or usefulness of any food product should not be misleading or deceiving. The Cigarettes and other Tobacco Products (Prohibition of Advertisement and Regulation of Trade and Commerce, Production, Supply and Distribution) Act 2003 prohibits any direct and indirect advertisement of tobacco products. There are other industry-specific laws and an examination of these laws is important to determine whether there is any restriction on the supplier's or distributor's ability to advertise and market the products it sells. Apart from this, the Advertising Standards Council of India (ASCI), a non-statutory and self-regulatory body, has issued a Code for Self Regulation in Advertising (the ASCI Code), which applies to persons involved in the commissioning, creation, placement or publishing of advertisements. The ASCI Code does not have any statutory force and is merely considered good practice, but has been adopted by various advertising industry bodies.

A supplier may pass on any or all costs incurred by it in advertising the contract products to its distributor. In a similar vein, the supplier may also share the costs incurred by its distributor in advertising the concerned products.

Law stated - 30 January 2024

Intellectual property

27 How may a supplier safeguard its intellectual property from infringement by its distribution partners and by third parties? Are technology transfer agreements common?

The rights of an intellectual property holder are protected under common law in India in cases where there is no registration of intellectual property; however, it is advisable that suppliers register their intellectual property to seek protection under statutory laws. Registration of intellectual property in India acts as prima facie proof of ownership in favour of the registered proprietor. Furthermore, to avoid misuse of intellectual property, a supplier should incorporate clear provisions in the agreement regarding the scope of intellectual property rights that are to be granted or licensed to its distributors. Periodic checks and monitoring of the physical and online market should be undertaken to identify potential infringements of rights so that timely action can be taken against the infringer.

India does not have any specific laws in respect of trade secrets and know-how, and the protection of trade secrets and know-how is purely contractual.

Law stated - 30 January 2024

Consumer protection

28 What consumer protection laws are relevant to a supplier or distributor?

In general, the following consumer protection laws and their accompanying rules and regulations may be relevant to a supplier or distributor: the Consumer Protection Act 2019; the Legal Metrology Act 2009; the Food Safety and Standards Act 2006; and the Competition Act 2002.

Law stated - 30 January 2024

Product recalls

29 Briefly describe any legal requirements regarding recalls of distributed products. May the distribution agreement delineate which party is responsible for carrying out and bearing the cost of a recall?

The laws relating to the recall of distributed products vary depending on the nature of the products. For example, the Consumer Protection Act 2019, which in general deals with the sale of products and services to individuals who are end consumers, provides that the

Central Consumer Protection Authority may order the recall of goods that are dangerous, hazardous or unsafe for consumers. The Food Safety and Standards Act 2006 requires food business operators (which includes manufacturers, packagers and distributors) to recall a food product at any stage of the supply chain that the food operator considers or has reason to believe has not been processed, manufactured or distributed in compliance with the applicable law, or where the product may pose a threat to the public health. The food operator recalling the product is also required to inform the competent authority about the recall and provide reasons for product withdrawal. Similarly, the Drugs and Cosmetics Act 1940 and Rules framed thereunder provide elaborate provisions for a recall and rapid alert system for drugs.

Generally, the parties are free to mutually agree and delineate their responsibilities and liabilities, if any, in the distribution agreement with respect to the recall of products.

Law stated - 30 January 2024

Warranties

30 To what extent may a supplier limit the warranties it provides to its distribution partners and to what extent can both limit the warranties provided to their downstream customers?

Under the Sales of Goods Act 1930 (SGA), where there is a contract for the sale of goods by description, there is an implied condition that the goods shall correspond with the description. In the case of a contract for sale by sample there is an implied condition that the bulk shall correspond with the sample in quality and the goods shall be free from any defect, rendering them unmerchantable, which would not be apparent on reasonable examination of the sample.

There is an implied warranty or condition regarding the fitness and quality of goods for the following:

- where the buyer, expressly or by implication, makes known to the seller the particular purpose for which the goods are required, to show that the buyer relies on the seller's skill or judgment, and the goods are of a description that it is in the course of the seller's business to supply, there is an implied condition that the goods shall be reasonably fit for such purpose;
- where goods are bought by description from a seller who deals in goods of that description, there is an implied condition that the goods shall be of merchantable quality; and
- an implied warranty or condition as to quality or fitness for a particular purpose may be annexed by the usage of trade.

Unless there is a contract to the contrary, the buyer has the right to initiate a product liability claim under the circumstances described above. Therefore, the supplier may contractually agree with its distribution partner to vary or extinguish the implied warranties and conditions provided under the SGA. Similarly, the supplier and its distribution partner may include

suitable disclaimers in the contract with its downstream customers for varying or excluding the implied warranties and conditions.

Law stated - 30 January 2024

Data transfers

31 Are there restrictions on the exchange of information between a supplier and its distribution partners about the customers and end users of their products? Who owns such information and what data protection or privacy regulations are applicable?

The Information Technology (Reasonable Security Practices and Procedures and Sensitive Personal Data or Information) Rules 2011 (the IT Rules) impose conditions on the collection, storage, processing, transfer and disclosure of 'sensitive personal data or information' of natural persons using computer resources. The IT Rules prescribe the manner in which sensitive personal data or information may be collected, transferred or disclosed by a business entity. These conditions include obtaining prior consent of the provider of information for disclosure and transfer of sensitive personal data or information. A body corporate handling sensitive personal data or information is obligated to implement and maintain certain reasonable security practices and procedures prescribed under the IT Rules, and no transfer of sensitive personal data or information should be made to an entity that does not ensure the same level of data protection that is adhered to by the transferee.

The IT Rules do not expressly clarify the ownership of sensitive personal data or information; however, the presumption is that the data is owned by the provider of the information.

Law stated - 30 January 2024

32 What requirements apply to suppliers and their distribution partners with respect to protecting the security of customer data they hold?

The IT Rules require that a body corporate collecting, storing, processing or handling sensitive personal data or information of natural persons using computer resources should implement security practices and standards that have a comprehensive documented information security programme and information security policies that contain managerial, technical, operational and physical security control measures that are commensurate with the information assets being protected. The international standard ISO/IEC 27001 'Information Technology – Security Techniques – Information Security Management System – Requirements' is an example of a security practice and standard.

Law stated - 30 January 2024

Employment issues

33 | May a supplier approve or reject the individuals who manage the distribution partner's business, or terminate the relationship if not satisfied with the management?

A supplier may do so, provided the distribution contract confers a right upon the supplier to take such action. However, such rights are rarely used by suppliers.

Law stated - 30 January 2024

34 | Are there circumstances under which a distributor or agent, or its employees, would be treated as an employee of the supplier, and what are the consequences of such treatment? How can a supplier protect against responsibility for potential violations of labour and employment laws by its distribution partners?

It is unlikely that a distributor or agent or its employees would be treated as an employee of the supplier. However, it is always advisable to clarify this aspect in the contract between the supplier and its distributor or agent, especially where the supplier or the agent is an individual.

Law stated - 30 January 2024

Commission payments

35 | Is the payment of commission to a commercial agent regulated?

Payment of commission to a commercial agent is not regulated under Indian law, except in defence and government procurement deals. In accordance with the Indian Contract Act 1872, no consideration is necessary to create an agency. Provisions relating to the commission payable to an agent are agreed upon mutually by the parties to a contract.

Law stated - 30 January 2024

Good faith and fair dealing

36 | What good faith and fair dealing requirements apply to distribution relationships?

The Indian Contract Act 1872 does not expressly incorporate the doctrine of good faith. However, several courts have opined that every contract inherently includes the principle of good faith.

Law stated - 30 January 2024

Registration of agreements

37 | Are there laws requiring that distribution agreements or intellectual property licence agreements be registered with or approved by any government agency?

Distribution agreements or intellectual property licence agreements are not required to be approved by any government agency. Furthermore, registration of such agreements is not mandatory.

Law stated - 30 January 2024

Anti-corruption rules

38 To what extent are anti-bribery or anti-corruption laws applicable to relationships between suppliers and their distribution partners?

The Prevention of Corruption Act 1988 (PCA) is the primary anti-corruption legislation in India. The PCA criminalises the offering of undue advantage to induce or reward any public servant for the improper performance of his or her public duty. Currently, there is no law to regulate private commercial bribery.

In accordance with the PCA, a commercial organisation can be punished with a fine, if any 'person associated' with the commercial organisation gives or promises to give any undue advantage to a public servant to obtain any advantage for the conduct of business or to retain business for the commercial organisation. A commercial organisation will be able to avoid prosecution only if it is able to prove that it had in place adequate procedures that comply with the guidelines prescribed under the PCA to prevent persons associated from undertaking such conduct. The government is yet to frame guidelines for commercial organisations regarding the control or supervision they should exercise over the associated persons to prevent them from offering any undue advantage to a public servant on behalf of the organisation.

A person is said to be associated with a commercial organisation if he or she performs services for or on behalf of the commercial organisation irrespective of any promise to give any undue advantage to a public servant. Whether a person can be classified as a 'person associated' with a commercial organisation will be determined by reference to all the relevant circumstances and not merely by reference to the nature of the relationship between the person and the commercial organisation.

A supplier may be liable under the PCA if a distributor offers any bribe to a public servant to secure any business for the products of the supplier, unless the supplier is able to prove that sufficient control was put in place to prevent the distributor from offering any bribe to a public servant.

Law stated - 30 January 2024

Prohibited and mandatory contractual provisions

39 Are there any other restrictions on provisions in distribution contracts or limitations on their enforceability? Are there any mandatory provisions? Are there any provisions that local law will deem included even if absent?

The Indian Contract Act 1872 recognises the freedom of parties to contract freely and does not prescribe any mandatory provisions to be included in the distribution contract. However, there are certain provisions that will not be enforceable even if they are included in a contract. For example, any provision where a party is absolutely restricted from instituting legal proceedings to enforce its legal rights is void. A contract will also be void if:

- it is uncertain;
- both parties to the contract have misunderstood a matter of fact essential to the contract; and
- the consideration or object of the contract is of such a nature that, if permitted, it would defeat the provisions of any local law or is fraudulent, or involves or implies injury to the person or property of another, or is contrary to public policy.

Furthermore, a contract where consent of a party was obtained through coercion, undue influence, fraud or misrepresentation is voidable at the option of the party that gave consent.

Law stated - 30 January 2024

GOVERNING LAW AND CHOICE OF FORUM

Choice of law

40 Are there restrictions on the parties' contractual choice of a country's law to govern a distribution contract?

Although Indian law does not expressly prohibit a foreign party from agreeing to foreign governing law in a contract with an Indian party, Indian courts are not comfortable adjudicating disputes under such contracts due to their lack of familiarity with foreign law.

A foreign party may opt for foreign governing law should it decide to resolve disputes through arbitration seated in India or in a foreign country.

Law stated - 30 January 2024

Choice of forum

41 Are there restrictions on the parties' contractual choice of courts or arbitration tribunals, whether within or outside your jurisdiction, to resolve contractual disputes?

While there are no restrictions on the parties' contractual choice of courts or arbitration tribunals (whether in India or a foreign country) to resolve disputes, this choice must be made carefully after analysing the challenges that may be faced during enforcement of judgments of foreign courts or foreign arbitration awards in India.

In accordance with the Code of Civil Procedure 1908, a conclusive foreign judgment passed by a foreign 'superior court' situated in 'reciprocating territory' can be enforced in India. A 'reciprocating territory' means a foreign country that is notified as a reciprocating

territory by the central government of India for the purpose of enforcement of foreign judgments. The term 'superior courts' means courts situated in a reciprocating territory and notified by the central government of India as superior courts.

The parties to an international distribution agreement may opt to arbitrate either in or outside India. In accordance with the Arbitration and Conciliation Act 1996, foreign arbitration awards can be enforced in India if they are passed in a country that is notified by the government of India and is also a signatory to either the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (commonly known as the New York Convention) or the Geneva Convention on the Execution of Foreign Arbitral Awards (commonly known as the Geneva Convention).

Law stated - 30 January 2024

Litigation

42 What courts, procedures and remedies are available to suppliers and distribution partners to resolve disputes? Are foreign businesses restricted in their ability to make use of these courts and procedures? Can they expect fair treatment? To what extent can a litigant require disclosure of documents or testimony from an adverse party? What are the advantages and disadvantages to a foreign business of resolving disputes in your country's courts?

Indian law does not prescribe a separate set of procedures for the resolution of disputes involving distributors and suppliers. If a distributor or supplier decides to resolve their dispute in an Indian court, all such disputes will be resolved according to the Code of Civil Procedure 1908, which applies to all contractual and other civil cases.

India has a unified judicial system, with the Supreme Court at the top of the hierarchy followed by the high courts of each state. The district court is positioned below the state's high court and is followed by various subordinate courts. In addition to the regular civil courts, various tribunals (including appellate tribunals) have been set up for specialised matters, such as income taxes, debt recovery, intellectual property and company law. Appeals from the orders of these tribunals lie with the designated appellate tribunals, the state's high court or the Supreme Court, as the case may be.

With the exception of the Supreme Court, each court in India has a defined territorial limit over which it can exercise its jurisdiction. Furthermore, a pecuniary limit has been prescribed for all district and subordinate courts, and a court cannot exercise jurisdiction over a matter whose value exceeds the pecuniary limit set for that court. Generally, subject to the applicable pecuniary limit, a suit should be filed in the court that has jurisdiction over the place where the cause of the action arose, or where the defendant resides or carries on its business. Appeals from subordinate courts lie with the state's district court. Similarly, an appeal from a district court can be filed with the state's high court and then with the Supreme Court.

Indian procedural law treats a foreign party fairly and equally to an Indian party. No additional benefits or advantages are conferred to a foreign party over an Indian party desiring to resolve disputes through Indian courts. However, resolution of disputes in Indian

courts is likely to result in protracted litigation owing to a huge backlog of cases and slow disposal rates.

Law stated - 30 January 2024

Alternative dispute resolution

43 Will an agreement to mediate or arbitrate disputes be enforced in your jurisdiction? Are there any limitations on the terms of an agreement to arbitrate? What are the advantages and disadvantages for a foreign business of resolving disputes by arbitration in a dispute with a business partner in your country?

The Arbitration and Conciliation Act 1996 (the Arbitration Act) governs domestic arbitration, international commercial arbitration and the enforcement of foreign arbitral awards. The Arbitration Act defines an international commercial arbitration as an arbitration involving commercial disputes arising from a legal or contractual relationship between two or more parties, wherein one of the parties is a foreigner.

The parties to an international distribution agreement may opt to arbitrate either in India or outside India in any country that is notified by the government of India and is also a signatory to either the New York Convention or the Geneva Convention.

The Arbitration Act requires that the arbitration agreement by the parties to submit to arbitration all or certain disputes between them in respect of a defined legal relationship should be made in writing. An arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement. An arbitration agreement is deemed to be in writing if it is contained in an exchange of letters, telex, telegrams or other means of telecommunication, including communication through electronic means, that provide a record of the agreement.

No additional benefits or advantages are conferred to a foreign party over an Indian party desiring to resolve disputes through arbitration. However, arbitration of disputes, as opposed to litigation in court, provides a speedy remedy.

Law stated - 30 January 2024

UPDATE AND TRENDS

Key developments

44 Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? Are there any other current developments or trends that should be noted?

In August 2023, India's central legislature passed the Digital Personal Data Protection Act 2023 (DPDPA), the country's first comprehensive legislation regarding personal data privacy. Although the DPDPA has been passed by the Union Parliament and received Presidential assent (and has hence become law), it will be put in force at a future date to be notified by the government. It is also possible that the DPDPA will be put into force in

a phased manner with some sections being notified before others, and longer compliance timelines being afforded for some of the more intensive compliance requirements.

The enforcement of the DPDPA is contingent on the establishment of an independent data protection authority – the Data Protection Board of India – as well as the publishing of a multitude of subordinate legislations referred to as 'Rules' that will govern many of the procedural aspects of the law.

The DPDPA puts into place specific obligations on data controllers (referred to in the law as data fiduciaries) regarding obtaining consent of data subjects (referred to in the law as data principals) for processing their personal data, ensuring data minimisation and purpose limitation, data breach notification requirements, and instituting grievance redressal mechanisms for data subjects. The law also provides data subjects with various rights (such as right to access, correction and erasure of personal data, and the right to withdraw consent) and makes data controllers squarely responsible for ensuring that these rights are provided to data subjects.

Penalties under the DPDPA have also been significantly enhanced from the current regime, with contraventions of the DPDPA punishable with penalties of up to 2.5 billion rupees.

Indian suppliers and distributors who act as data controllers under the DPDPA, as well as foreign entities who may fall under this classification, would be liable for compliance with the DPDPA once it is put in force.

The Competition Act was also amended in 2023 with several significant changes being put into force. Changes relevant to agency and distribution arrangements include expansion of the scope of 'anticompetitive' agreements to include hub-and-spoke arrangements wherein parties who are not directly involved in trading of similar goods but are facilitating such arrangements would also be presumed to be part of the anticompetitive agreement. The amendment has also added a provision that allows for the compounding of offences (which has already been put into force), and has introduced commitment and settlement mechanisms for contravention of the Competition Act (which will be put into force at a later date).

Law stated - 30 January 2024

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Summary

GOVERNING LAW AND CHOICE OF FORUM

UPDATE AND TRENDS

DIRECT DISTRIBUTION

Ownership structures

1 | May a foreign supplier establish its own entity to import and distribute its products in your jurisdiction?

Yes, a foreign supplier may establish a Japanese subsidiary by completing the registration required under article 818 of the Companies Act. However, there are individual laws that restrict foreign ownership (eg, the Act on Nippon Telegraph and Telephone Corporation, etc, the Radio Act and the Civil Aeronautics Act). In addition to the regulations under individual industry laws, the Foreign Exchange and Foreign Trade Law imposes pre-notification and post-notification requirements on foreign investments based on security and other purposes.

Law stated - 31 January 2024

2 | May a foreign supplier be a partial owner with a local company of the importer of its products?

Yes, with the exception of certain industries, a foreign company may partially own a Japanese company as the importer of its products.

Law stated - 31 January 2024

3 | What types of business entities are best suited for an importer owned by a foreign supplier? How are they formed? What laws govern them?

Of the entity forms recognised under the Companies Act, the two most commonly used are company limited by shares (*kabushiki kaisha*) and limited liability companies (LLCs) (*godo kaisha*).

Under the Companies Act, the registration for establishing a company limited by shares requires the following:

- preparing the articles of incorporation;
- obtaining a certified copy of the register and the necessary documents of the incorporator, preparing an affidavit regarding the profile of the incorporator and preparing an affidavit regarding the incorporator's signature;
- notarisation of the articles of incorporation by a Japanese notary public;
- payment of the full amount of capital;
- appointment of directors (directors are required to investigate the legality of the incorporation of the company); and
- application to the Legal Affairs Bureau for registration of establishment of the company (there is a registration tax of 0.7 per cent of the amount of capital (minimum ¥150,000)).

For an establishment of an LLC, the procedures, except for the following points, are the same as for the formation of a company limited by shares:

- notarisation of the articles of incorporation is not required;
- appointment of a representative partner or an executive partner (or both), instead of appointing directors; and
- there is a registration tax of 0.7 per cent of the amount of capital (minimum ¥60,000).

The liability of the members of a limited liability company is limited to the amount of each member's investment, similar to the liability of the shareholders of a company limited by shares. In addition, the housekeeping matters (corporate governance structure, commercial registration) of a limited liability company are simpler than those of a company limited by shares, and the establishment costs (including registration costs) are lower.

Law stated - 31 January 2024

Restrictions

4 | Does your jurisdiction restrict foreign businesses from operating in the jurisdiction, or limit foreign investment in or ownership of domestic business entities?

Yes, some industrial laws prohibit foreign ownership of Japanese business entities.

Laws that impose certain restrictions on (1) the percentage of shares that can be acquired by foreign corporations or individuals, and (2) appointment of directors are:

- the Act on Nippon Telegraph and Telephone Corporation, etc;
- the Radio Act;
- the Broadcasting Act;
- the Consigned Freight Forwarding Business Act;
- the Civil Aeronautics Act; and
- the Law prohibiting foreign corporations or individuals from becoming businesses: the Mining Act.

Law stated - 31 January 2024

Equity interests

5 | May the foreign supplier own an equity interest in the local entity that distributes its products?

Yes, but from a security perspective, the Foreign Exchange and Foreign Trade Act requires prior notification or subsequent reporting to the Minister of Finance, when foreign corporations or individuals invest in Japanese companies.

If the Japanese company is engaged in businesses in the following industries, prior notification is required: aircraft, weapons, nuclear power, space exploration, energy, water, telecommunications, broadcasting, railroads, bus lines, coastal shipping, petroleum, leather, footwear, agriculture, forestry, fishing, security, pharmaceuticals and other industries.

Whether or not a Japanese company in which a foreign investor invests is engaged in the businesses that require prior notification should not be judged solely on the basis of the business purpose stated in the articles of incorporation of such company, but rather on the basis of the actual business activities thereof. In particular, a detailed business analysis is required if the Japanese company is engaged in the software business, the information processing business or the internet support business. In analysing such Japanese company's business, the Japan Standard Industrial Classification is commonly used.

Foreign investment in Japanese companies engaged in businesses other than those requiring the above prior notification must be reported after the fact. However, this subsequent notification must be made within 15 days of the foreign corporation or individual acquiring the shares of such Japanese company.

Law stated - 31 January 2024

Tax considerations

6 What are the tax considerations for foreign suppliers and for the formation of an importer owned by a foreign supplier? What taxes are applicable to foreign businesses and individuals that operate in your jurisdiction or own interests in local businesses?

Non-resident individuals

Income derived from business activities conducted by a non-resident individual is taxable as Japanese source income only if the individual has a permanent establishment (PE) in Japan and the income is attributable to the PE. Therefore, if a non-resident individual who does not have a PE in Japan sells his or her products directly to Japanese customers, the income from these sales is not taxable for Japanese individual income tax purposes. Under most tax treaties between Japan and other countries, facilities 'used exclusively for the storage, display or delivery of goods' are excluded from the PE concept.

Foreign companies

Income from the business activities of a foreign corporation that does not have a PE in Japan is not taxed as Japanese source income for Japanese corporate income tax purposes. In this case, the foreign corporation must file an application form of foreign ordinary corporation within two months of the date of establishment of the branch office and file a tax return with the relevant local tax office each year within two months of the date following the end of the foreign corporation's fiscal year.

Subsidiary

If a foreign supplier establishes a Japanese corporation to import products, the Japanese corporation's worldwide income (not limited to Japan-sourced income) is subject to Japanese corporate income tax, local resident tax and local enterprise tax.

On the other hand, income earned by a foreign supplier as a parent company selling products to a Japanese subsidiary is not subject to Japanese corporate income tax. If the transfer price of the product from the parent foreign supplier to the Japanese subsidiary is higher than the arm's-length transaction price, no Japanese corporate income tax is imposed.

If the transfer price of the product from the foreign supplier to the Japanese subsidiary is higher than the arm's-length price, the Japanese corporate income tax is calculated as if the transfer price of the distribution transaction had been reduced to the arm's-length price, and the Japanese subsidiary is subject to additional Japanese corporate income tax on the difference between the actual transfer price and the arm's-length price.

Law stated - 31 January 2024

LOCAL DISTRIBUTORS AND COMMERCIAL AGENTS

Distribution relationships

7 | What alternative distribution relationships are available to a supplier?

A foreign supplier may select a wide range of schemes. Generally, the following distribution relationships are used in Japan:

- a distributor, which conducts transactions in its own name and on its own account, purchases and resells items on its behalf and account;
- sales by way of franchise (including trademark licensing), and private label and joint venture (both of which are permitted in Japan) are also forms of selling items in one's own name and for one's own account, as are distributors;
- a commercial agent is a person or entity whose business is to 'represent or act as an agent' for a particular merchant in transactions that fall within its business category on an ongoing basis (eg, insurance agent). There are two types of commercial agents: a contracting agent, whose business is to act as an agent for transactions; and an intermediary agent, whose business is to act as an intermediary. As a commercial agent acts only as a representative or an agent, it is not subject to any rights and obligations.
- A broker is a person or entity who enters into a brokerage agreement with an unspecified number of merchants and arranges transactions between these merchants (eg, real estate agent). Although a broker facilitates the transaction, it is not a party to the transaction and, therefore, is not subject to any rights or obligations (article 543 of the Commercial Code).

- A commission agent conducts transactions on behalf of others, acting as a seller or buyer itself. In other words, a commission agent is subject to the rights and obligations arising from the transactions (eg, securities company). A commission agent may also conduct transactions for an unspecified number of merchants (article 551 of the Commercial Code).

Law stated - 31 January 2024

Legislation and regulators

8 What laws and government agencies regulate the relationship between a supplier and its distributor, agent or other representative? Are there industry self-regulatory constraints or other restrictions that may govern the distribution relationship?

In general, there is no regulatory scheme applicable to distribution agreements. Therefore, parties are free to enter into a distribution agreement on any terms and conditions; however, the application of the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade should always be considered in any form of distribution relationship. Specifically, transactions that may restrict free competition in the market (eg, resale price maintenance and deceptive customer inducements) are prohibited by the Act. In addition, if the distribution relationship meets the legal definition of the *tokutei rensaka jigyo* (franchise business related to convenience stores and other retail businesses), the supplier (franchisor) is required to provide the other party to this agreement with a written explanation of the matters required by the Small and Medium-sized Retail Business Promotion Act in advance. Even in the case of a distribution relationship that is a franchise that does not fall under the category of the*tokutei rensaka jigyo*, the same document as above is required to be disclosed in advance based on the Guidelines concerning the Franchise System, although it is not legally required.

When a distribution relationship arises with respect to a specific type of business, the laws regulating that type of business apply (eg, the Insurance Business Act when operating an insurance business as a commercial agent, the Real Estate Brokerage Act when operating a real estate brokerage business as a broker and the Financial Instruments and Exchange Act when operating a securities business as a commission agent).

Japan acceded to the United Nations Convention on Contracts for the International Sale of Goods, which has been effective since August 2009.

Law stated - 31 January 2024

Contract termination

9 Are there any restrictions on a supplier's right to terminate a distribution relationship without cause if permitted by contract? Is any specific cause required to terminate a distribution relationship? Do the answers differ for a decision not to renew the distribution relationship when the contract term expires?

Although the decisions of the Japanese courts on whether or not to terminate or renew distribution agreements are not consistent (and vary from case to case), they can generally be grouped into the following two concepts.

Concept one

In principle, decisions should be made in accordance with the provisions of the distribution contract, and only if allowing termination or non-renewal would violate general restrictions such as the principle of good faith and fair dealing, should termination or non-renewal be restricted.

Particularly for distribution agreements, which are generally entered into on a business-to-business basis, this approach emphasises that the intent of the parties at the time the agreement was entered into is reflected in the terms of the agreement and that, in principle, judgment will be rendered in accordance with the terms of the agreement.

Concept two

To cancel or non-renew a distribution agreement, it is necessary to find compelling circumstances for such cancellation or non-renewal.

This concept is from a line of cases on 'contracts continuing for a long term' developed from the German concept of *Dauerschuldverhältniss*. The theory is that a contract that has continued for a long period of time cannot be unilaterally terminated without compelling reasons, even if the term is specified in the contract. The compelling reasons must be comprehensively considered with certain factors:

- type and content of the contracts;
- need for protection of the contracting party (how much human and material investments have been made, whether or not a prior notice for termination was given, whether or not compensation for losses was provided, etc);
- necessity of the termination;
- purpose of the contract; and
- duration of the contract.

If the distribution relationship meets the legal definition of a commercial agent, the commercial agent may terminate an agreement by giving two months' prior notice to the other party if the agreement does not specify a term, and terminate an agreement at any time with compelling reasons (article 30 of the Commercial Code).

Law stated - 31 January 2024

10 Is any mandatory compensation or indemnity required to be paid in the event of a termination without cause or otherwise?

As there is no statute that mandates compensation at the time of termination, whether the compensation or indemnification is required is based on the concepts of termination of distribution agreements. Namely, if the parties (and the court) adopt the concept that compelling circumstances are required to terminate a distribution agreement, the existence of compensation or indemnification will be considered one of the factors to be taken into account for compelling reasons as cause to authorise termination. On the other hand, if relying on the other concept, compensation and indemnification are not required.

Law stated - 31 January 2024

Transfer of rights or ownership

11 Will your jurisdiction enforce a distribution contract provision prohibiting or restricting the transfer of the distribution rights to the supplier's products, all or part of the ownership of the distributor or agent, or the distributor or agent's business to a third party?

Under Japanese law, an assignment of rights and obligations made in violation of the prohibition on the assignment of rights and obligations in a distribution agreement is considered valid. In this case, the debtor of the assigned obligation may: (1) refuse to pay the assignee who knew or was grossly negligent with respect to the prohibition and claim payment or other grounds against the assignor; or (2) if the assigned obligation is for the payment of money, the full amount of the obligation may be deposited at the place of performance of the obligation whether or not the assignee knew of the existence of the prohibition.

For transferring ownership, there is no statute for such enforcement; however, foreign investments shall always be subject to the Foreign Exchange and Foreign Trade Act and individual acts for specific industries.

Law stated - 31 January 2024

REGULATION OF THE DISTRIBUTION RELATIONSHIP

Confidentiality agreements

12 Are there limitations on the extent to which your jurisdiction will enforce confidentiality provisions in distribution agreements?

In Japanese courts, violations of confidentiality provisions are subject to enforcement, as are other provisions.

Law stated - 31 January 2024

Competing products

13 Are restrictions on the distribution of competing products in distribution agreements enforceable, either during the term of the relationship or afterwards?

As the restrictions on the distribution of competing products may be a restriction on the freedom of choice of occupation recognised under the Constitution of Japan, certain limitations are required on the validity of the restriction. However, it is unclear what kind of limitations are required to make the provision effective. While there is a Supreme Court precedent that held that a restriction on the distribution of competing products is only recognised when the restricted period, area and type of business are limited, and that a restriction clause without these limitations is invalid because it violates public order and morality, subsequent court decisions have held that a restriction on the distribution of competing products is valid even when the restricted period is not limited, on the grounds that the place of non-competition is limited to one place and the type of business restricted is limited to the same business in the same industry as that during the term of the distribution contract. In light of this lack of clarity, in Japanese practice, a common restriction clause stipulates a specific type of business within a specific scope for a specific number of years (two to five years, depending on the case) after the termination of the contract.

With regard to exclusive distributorship agreements, it is illegal to impose a restriction on the distribution of competing products even after the termination of the agreement, unless it is necessary for legitimate purposes such as the protection of trade secrets, as this would constitute a restriction on transactions in accordance with the Guidelines Concerning Distribution Systems and Business Practice (the Guidelines).

Law stated - 31 January 2024

Prices

14 May a supplier control the prices at which its distribution partner resells its products? If not, how are these restrictions enforced?

Controlling resale prices constitutes an unfair trade practice and is illegal, unless there is a legitimate reason to do so (article 2(9)(iv) of the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade). A 'legitimate reason' is recognised only to the extent necessary and for the necessary period if the restraint by the supplier on the resale price of its own goods actually has a pro-competitive effect and promotes inter-brand competition, thereby increasing demand for the goods and promoting the interests of consumers, and the pro-competitive effect cannot be caused by any other less competition-inhibiting method other than the restraint on resale prices.

Law stated - 31 January 2024

15 May a supplier influence resale prices in other ways, such as suggesting resale prices, establishing a minimum advertised price policy, announcing it will not deal with customers who do not follow its pricing policy, or otherwise?

It is unlawful for a supplier to substantially influence the resale price. Whether or not the resale price is effectively controlled (ie, whether or not the controlling constitutes an unfair trade practice) is determined by whether or not the reseller is deemed to be effective in selling the product at the price offered by the supplier through artificial means. According to

the Guidelines, the effectiveness of sales at the price offered by the supplier is considered to be ensured in the following cases:

- if the supplier and the distributor agree to sell the product at the price indicated by the business operator, whether in writing or orally, such as:

  - where a written or oral contract stipulates that the product will be sold at the price indicated by the supplier;
  - where the distributor is required to submit a written agreement to sell the product at the price indicated by the supplier;
  - where the supplier offers to sell the product at the specified price as a condition of the transaction and the supplier deals only with distributors who accept the condition; or
  - where the products are sold at the price indicated by the supplier, and the distributors are required not to discount unsold products and the supplier re-purchases the unsold products; and

- if the supplier causes the distributor to sell at the price indicated by the supplier by using some artificial means such as imposing or suggesting the imposition of an economic disadvantage if the distributor does not sell at the price indicated by the supplier. This includes the following cases:

  - where the supplier imposes or notifies of economic disadvantages such as suspension of shipment (including reduction of shipment volume, increase of shipment price, reduction of rebate and refusal of supply of other products; the same shall apply hereinafter);
  - where the supplier imposes, or notifies or suggests to the distributor that the supplier will impose economic benefits such as rebates (including reduction of shipment prices and supply of other products; the same shall apply hereinafter);
  - where the supplier causes the distributor to sell the goods at the price indicated by the supplier by collecting reports on selling prices, patrolling stores, monitoring prices by dispatched clerks, and inspecting books and other documents, to check whether the goods are sold at the indicated price;
  - where the distribution route to a distributor engaged in a bargain sale is identified by assigning a secret number to the goods, and the distributor who has sold the goods to the distributor is requested not to sell the goods to the discount distributor so that the goods are sold at the price indicated by the supplier;
  - where the supplier has purchased the goods of a distributor engaged in a bargain sale, has the distributor or the distributor who is selling these goods to purchase the goods, or has the distributor sell the goods at the price indicated by the supplier by charging the purchase cost; or
  - where the distributor who is selling the goods at a low price is made to sell the goods at the price indicated by the supplier by taking up complaints from

other distributors about the low price and requesting them to not sell the goods at the low price.

Law stated - 31 January 2024

16 May a distribution contract specify that the supplier's price to the distributor will be no higher than its lowest price to other customers?

A supplier may specify its desired retail price in a non-binding statement such as 'recommended retail price' or 'reference price'; however, effectively binding the resale price by the distributor is regarded as an unfair trade practice and is illegal.

Law stated - 31 January 2024

17 Are there restrictions on a seller's ability to charge different prices to different customers, based on location, type of customer, quantities purchased, or otherwise?

In addition to resale price restraints, the following types of restrictions may also fall under the category of unfair trade practices:

- where the supplier restricts transactions with companies or products that compete with the supplier. This includes requiring a distributor to notify a competitor of the supplier's offer to continue business with the supplier and to promise that the distributor will offer the same or a lower price than that offered by the competitor;
- where the price holding effect occurs by restricting a distributor's sales territory;
- where the price holding effect occurs by imposing specific restrictions on the distributor, such as requiring bookkeeping or prohibiting peer trading;
- where a supplier establishes certain standards (eg, sales methods and quality control instructions) for handling its products, and these standards exceed the scope of what is considered reasonable from the standpoint of quality maintenance, ensuring appropriate use, and the interests of consumers; and
- where a dominant supplier in the market of a certain product (main product) causes distributors to purchase other products (subordinate products) in conjunction with the supply of the main product, thereby creating a market-closing effect in the market of the subordinate product.

Law stated - 31 January 2024

Geographic and customer restrictions

18 May a supplier restrict the geographic areas or categories of customers to which its distribution partner resells? Are exclusive territories permitted? Is there a distinction between active sales efforts and passive sales that are not actively solicited, and how are those terms defined?

The Guidelines provides that it is not illegal for a supplier to impose a geographic restriction or a sales base system for distributors to establish efficient sales bases for products or to secure an after-sales service system, unless it falls under a strict regional restriction (which means that a supplier assigns a certain region to a distributor and restricts sales outside the region) and causes the price maintenance effect. On the other hand, if a supplier restricts distributors from passively selling to customers outside the region (which means a supplier assigns a certain region to a distributor and restricts sales upon the request from customers outside the region) and this causes the effect of maintaining prices, it constitutes an unfair trade practice and is illegal. The effect of maintaining the price is judged by the inter-brand as well as the intra-brand competition, the number and status of distributors subject to the restriction as well as the extent of the impact of the restriction.

Law stated - 31 January 2024

19 | If geographic and customer restrictions are prohibited, how is this enforced?

If geographic and customer restrictions constitute an unfair trade practice (transactions with restrictive conditions), the Fair Trade Commission will issue a cease-and-desist order that instructs a party to stop a specific activity, delete the contractual terms, or conduct other measures necessary to eliminate the activity (article 20 of the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade. If the supplier violates the order, it will be subject to a non-penal fine of not more than ¥500,000 (article 97 of the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade). Further, there is a possibility of civil claims for damages from entities that have suffered damage due to these geographic and customer restrictions.

Law stated - 31 January 2024

Online sales

20 | May a supplier restrict or prohibit e-commerce sales by its distribution partners?

There has been no discussion with regard to contractual territory and use of the internet by the distributor. It could be regarded as the sales to unsolicited customers outside the contractual territory and would be subject to unfair trade practice. In practice, therefore, it is advised to be sufficiently cautious in this regard. The final result depends on the market analysis over whether or not there is an effect of maintaining the price of the goods.

Law stated - 31 January 2024

21 | May a distributor or agent restrict a supplier's sales through e-commerce intermediaries into the distribution partner's territory? May it require the supplier to obtain reports of such sales by territory and a payment of 'invasion fees' or similar amounts to the distribution partner?

As there is no discussion of regulation, let alone statutes regarding e-commerce distribution, parties may stipulate these provisions in contracts; however, if the distributor has strong bargaining power (eg, if the distributor is a major retailer and the supplier only does business with the retailer), this may be a case of an abuse of a superior bargaining position (article 2(9)(v) of the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade).

Law stated - 31 January 2024

Refusal to deal

22 Under what circumstances may a supplier refuse to deal with particular customers? May a supplier restrict its distributor's ability to deal with particular customers?

It may be illegal as a non-price restrictive act if a supplier restricts its distributors' customers. In general, non-price restrictive acts have different effects on competition in the market for each type of act and each specific case. In other words, there are two types of non-price restrictive acts. One type is an act not judged to be illegal only based on the type of act, but also on whether there is a risk of impeding fair competition, such as a market closing effect or price maintenance effect, depending on the market position of the entity who engages in the act. Another is an act that is judged to be likely to impede price competition, and therefore to be judged, in principle, to be likely to impede fair competition, regardless of the market position of the operator engaging in the conduct in question.

Law stated - 31 January 2024

Competition concerns

23 Under what circumstances might a distribution or agency agreement be deemed a reportable transaction under merger control rules and require clearance by the competition authority? What standards would be used to evaluate such a transaction?

Pursuant to article 47(1)(i) of the Act on Prohibition of Private Monopolization and Maintenance of Fair Trade, the Fair-Trade Commission may request an entity suspected of violating the Act, such as acts of unfair restriction of trade or unfair trade practices, to report information necessary for the investigation of a case. If a report is not made or a false report is made, imprisonment with work for not more than one year or a fine of under ¥3 million will be imposed on this entity (article 94 of the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade). In some cases, a report may be requested based on voluntary cooperation of the entity, rather than a reporting order with indirect compulsion based on the provisions of article 47 of the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade.

Law stated - 31 January 2024

24

Do your jurisdiction's antitrust or competition laws constrain the relationship between suppliers and their distribution partners in any other ways? How are any such laws enforced and by which agencies? Can private parties bring actions under antitrust or competition laws? What remedies are available?

In addition to a surcharge payment order, the Fair Trade Commission may issue only a warning or caution to an entity, depending on the degree of violation. Although actions based on a violation of the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade are the exclusive jurisdiction of the Fair Trade Commission, private parties may also file civil claims for damages against the entity.

Law stated - 31 January 2024

Parallel imports

25 Are there ways in which a distributor or agent can prevent parallel or 'grey market' imports into its territory of the supplier's products?

Under certain conditions, parallel imports may legally be distributed, and the distributor may not seek injunctive relief or damages for these parallel imports. For example, if a product is legally trademarked by the trademark owner, consumers may distinguish the products having the same mark of origin as the trademark owner in Japan (the distributor who licensed the trademark from the supplier), and if the product is of the same quality as the product sold by the distributor in Japan, the product may be sold as a legitimate parallel import. If a distributor is an exclusive trademark licensee it may seek injunctions and damages for imported goods that do not fulfil the requirements (articles 30 and 36 of the Trademark Act). Those who are not an exclusive licensee or are just an agent may seek preventative measures together with the trademark rights holder.

Law stated - 31 January 2024

Advertising

26 What restrictions exist on the ability of a supplier or distributor to advertise and market the products it sells? May a supplier pass all or part of its cost of advertising on to its distribution partners or require them to share in its cost of advertising?

As there is no statute regulating the cost of advertising, the cost of advertising may be freely defined in the distribution contract.

Law stated - 31 January 2024

Intellectual property

27 How may a supplier safeguard its intellectual property from infringement by its distribution partners and by third parties? Are technology transfer agreements common?

Suppliers may seek injunctive relief or damages for any use of these intellectual property rights beyond the scope of the distributor's licence agreement or for any unlicensed use by a third party. In Japanese practice, it is not common for intellectual property rights to be assigned to a distributor, and rather a licence agreement is often concluded.

Law stated - 31 January 2024

Consumer protection

28 | What consumer protection laws are relevant to a supplier or distributor?

The Product Liability Act provides that those who have manufactured, processed or imported the product in the course of business (article 2(3)(i) of the Product Liability Act), those who have indicated their name or other identifier on the product as the manufacturer themselves or have indicated on the product in such a way as to mislead the public into believing that they are the manufacturer (article 2(3)(ii) of the Product Liability Act), and those who have indicated on the product that they are the actual manufacturer (article 2(3)(iii) of the Product Liability Act) shall be liable for damages to the life, body, or property caused to the consumer based on a defect in the product. The last category will mainly be applied to the supplier where there is no indication of the producer.

In addition, the Consumer Contract Act applies when distributors deal directly with consumers. The Act provides for consumer protection by strengthening the consumer's right to terminate the contract and voiding any clauses that are disadvantageous to the consumer.

Law stated - 31 January 2024

Product recalls

29 | Briefly describe any legal requirements regarding recalls of distributed products. May the distribution agreement delineate which party is responsible for carrying out and bearing the cost of a recall?

Provisions for recalls exist in individual laws and regulations. For example, a recall order may be issued by the Minister of Health, Labour and Welfare or a prefectural governor for food products containing illegal additives, toxic substances, etc (article 59 of the Food Sanitation Act). Under a distribution agreement, a provision that requires either party to bear the cost of recall is effective; however, it is questionable whether the provision is applicable when the recall is based on the intentional or grossly negligent act of the offending party.

In other cases, if a defective drug or other substance is found, the pharmaceutical company shall recall the drug or substance and report the recall to the Minister of Health, Labour and Welfare or the prefectural governor (article 68(9) and (11) of the Act on Securing Quality, Efficacy and Safety of Products Including Pharmaceuticals and Medical Devices), and the recall system for automobiles (including related

products such as tires and child seats in addition to the vehicle body) is statutorily-based to prevent accidents resulting from their design and manufacture (articles 63(2), 63(3), 63(4) and 64 of the Road Transport Vehicle Act).

Law stated - 31 January 2024

Warranties

30 To what extent may a supplier limit the warranties it provides to its distribution partners and to what extent can both limit the warranties provided to their downstream customers?

Although there have been no statutory or case law rules that invalidate the 'hold harmless' clause, it is doubtful that the courts will apply this clause to literally mean instances where the damages are caused by the supplier's wilful intention or gross negligence.

The same shall apply to contracts between distributors and downstream customers unless this customer is in an inferior bargaining position compared to the distributor, which may constitute a violation of the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade. The existence of a superior bargaining position is determined by considering:

- the degree of dependence of the customer on the distributor;
- the market share ratio of the distributor;
- the ease with which the customer can change suppliers; and
- the necessity to continue transactions with the distributor, including the number of transactions between the customer and the distributor.

Law stated - 31 January 2024

Data transfers

31 Are there restrictions on the exchange of information between a supplier and its distribution partners about the customers and end users of their products? Who owns such information and what data protection or privacy regulations are applicable?

In accordance with article 27 of the Act on the Protection of Personal Information-, when a 'business operator handling personal information' provides personal information obtained from a user to a third party, the business operator must obtain consent from the user in advance regarding the provision of the information to the third party. A 'business operator handling personal information' is defined as a person who uses personal information databases, etc, for business purposes. This includes not only corporations and sole proprietors, but also non-profit organisations such as condominium management associations, neighbourhood associations and alumni associations. The term 'personal information database' refers to a collection of information containing personal information, which is either (1) systematically organised so that it can be retrieved using a personal computer or (2) systematically organised so that specific personal information can be

retrieved by means of a table of contents or index, etc, or a combination of (1) and (2). The amount of personal information held in this database is irrelevant.

Whenever personal data is provided to a third party, a record of this provision must be kept and retained for a certain period of time. In addition, whenever a request for disclosure is received from the data subject, the company must respond to the request without delay.

Law stated - 31 January 2024

32 What requirements apply to suppliers and their distribution partners with respect to protecting the security of customer data they hold?

A customer's name, date of birth, address, email address and other identifying information are subject to protection as personal information (the Act on the Protection of Personal Information). Distributors and suppliers who receive personal information from distributors are required to take measures to protect personal information. Specifically, when distributors obtain personal information, they must obtain consent from each consumer to provide this information to a third party (supplier) (article 23 of the Act). In addition, when a distributor or supplier creates a database of personal information and uses it for business purposes, the distributor or supplier is required to clarify the scope of purpose (article 15 of the Act) and provide necessary and appropriate supervision of its employees to ensure that the personal information is managed securely (article 20 of the Act).

Law stated - 31 January 2024

Employment issues

33 May a supplier approve or reject the individuals who manage the distribution partner's business, or terminate the relationship if not satisfied with the management?

Based on the principle of freedom of contract, suppliers are free to enter into distribution contracts with individuals engaged in the distribution business. However, once a contract has been entered into with such an individual, the 'contracts continuing for a long term' theory may limit the non-renewal or termination of the contract.

Law stated - 31 January 2024

34 Are there circumstances under which a distributor or agent, or its employees, would be treated as an employee of the supplier, and what are the consequences of such treatment? How can a supplier protect against responsibility for potential violations of labour and employment laws by its distribution partners?

Freelancers (self-employed persons with no physical premises and no employer, or sole proprietors who use their own knowledge, experience and skills to generate income). The Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade applies to freelancers if the client of the transaction is an enterprise, and the Act against Delay

in Payment of Subcontract Proceeds, etc to Subcontractors applies if the client of the transaction is a corporation with a capital of ¥10 million or more. In those cases, freelancers will be protected through concepts such as preventing abuse of superior positions.

On the other hand, the labour laws only apply to a 'labourer', which is defined as a person who is employed by an enterprise and receives a wage (article 9 of the Labour Standard Act). Thus, the labourer is constituted by two elements: being employed and receiving a wage. The authority on these two elements is the report of the Study Group on Labour Standards of 19 December 1985. The report stated that the element 'employed' should be interpreted as 'controlled and supervised' and that it should be judged by the substance and not the form of the relationship between the two parties. According to the report, whether the person retains the freedom not to take up the specific assignment, whether the details and process of the work are instructed, whether the place and time to work are directed, and whether the person has the freedom to let another person do the work are the facts to be taken into consideration in judging the existence of 'control and supervision'. The report also stated that a 'wage' means any remuneration paid for the provisions of labour.

In practice, however, a formally independent person is rarely held to be a labourer in substance. A lower court has held that a commercial agent for the sale of insurance to not be an employee of the principal (insurance company) for the reason that the agent received no payment other than the commission in proportion to the insurance premium while incurring all the expenses for the sales activities (Tokyo Appeals Court, 16 December 1958). The decision echoes the decision by the Imperial Court prior to World War II on the commercial agent for the sale of insurance (Imperial Court, 21 June 1938).

Law stated - 31 January 2024

Commission payments

35 | Is the payment of commission to a commercial agent regulated?

In general, commissions for commercial agents are rarely regulated by law, but some industries (eg, insurance agencies) are required to regulate the total amount of commissions due to instructions from regulatory authorities.

Law stated - 31 January 2024

Good faith and fair dealing

36 | What good faith and fair dealing requirements apply to distribution relationships?

In addition to the regulations under the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade, the fair and equitable principle under the Civil Code applies as a general provision. For example, if, at the stage of negotiations for the conclusion of a contract, a party fails to investigate or inform the other party of important matters concerning the contents of the contract or acts in a manner that betrays the other party's reasonable expectations, thereby causing unforeseen damage to the other party after the

contract is concluded or as a result of the failure to conclude the contract, the party may be liable for damages as a breach of the fair and equitable principal. In addition, the 'contracts continuing for a long term' theory will apply to distribution relationships with respect to the termination or non-renewal of a distribution agreement.

Law stated - 31 January 2024

Registration of agreements

37 Are there laws requiring that distribution agreements or intellectual property licence agreements be registered with or approved by any government agency?

No distribution or licence contract registration is required. However, registration with the Patent Office is required when establishing an exclusive license for a patent or trademark (article 98 (1) (ii) of the Patent Act and article 2 of the Ordinance for Enforcement of the Trademark Act).

Law stated - 31 January 2024

Anti-corruption rules

38 To what extent are anti-bribery or anti-corruption laws applicable to relationships between suppliers and their distribution partners?

In Japan, there is no anti-corruption law directly applicable to distribution contracts; however, it should be noted that ordinances of each municipality prohibit transactions with anti-social forces (yakuza).

Law stated - 31 January 2024

Prohibited and mandatory contractual provisions

39 Are there any other restrictions on provisions in distribution contracts or limitations on their enforceability? Are there any mandatory provisions? Are there any provisions that local law will deem included even if absent?

In addition to the restrictions described herein, there are mandatory statutes that apply to all contracts. For example, contractual provisions that violate public order and morals (eg, criminal contractual details for the purpose of fraudulent provision of property) are considered invalid (article 90 of the Civil Code).

Law stated - 31 January 2024

GOVERNING LAW AND CHOICE OF FORUM

Choice of law

40 Are there restrictions on the parties' contractual choice of a country's law to govern a distribution contract?

Parties may choose the governing law of the distribution contract (article 7 of the Act on General Rules for Application of Laws). In this sense, it is also possible to choose a foreign law as the governing law of a distribution contract. In the absence of a choice of governing law by the parties, the place most closely related to the contract (the law applicable to the habitual residence of the party providing characteristic performance) is presumed (article 8 of the Act on General Rules for Application Law).

Law stated - 31 January 2024

Choice of forum

41 Are there restrictions on the parties' contractual choice of courts or arbitration tribunals, whether within or outside your jurisdiction, to resolve contractual disputes?

As to personal jurisdiction, the Japanese court will have personal jurisdiction over a defendant if the defendant has an address within Japan, or in the event that the address is unknown, if it has a domicile within Japan, or in the event the domicile is unknown, if it had an address within Japan before the filing of the case (article 3-2, the Code of Civil Procedure).

As for subject matter jurisdiction, Japanese courts will determine the jurisdiction in accordance with article 3-3 of the Code of Civil Procedure. Examples of the rules under article 3.3. are as follows:

- an action on a claim for performance of a contractual obligation: on a claim involving benevolent intervention in another's affairs that has been done, or unjust enrichment that has arisen, in connection with a contractual obligation; on a claim for damages due to non-performance of a contractual obligation; or on any other claim involving a contractual obligation – if the contractually specified place for performance of the obligation is within Japan, or if the law of the place adopted under the contract gives a place within Japan as the place for performance of the obligation (article 3-3(i) of the Code of Civil Procedure);
- an action on a property right: if the subject matter of the claim is located within Japan, or if the action is a claim for the payment of monies, and seizable property of the defendant is located within Japan (except when the value of such property is extremely low) (article 3-3(iii) of the Code of Civil Procedure);
- an action against a person with an office or a business office, which is filed in connection with the business conducted at that person's office or business office, if this office or business office is located within Japan (article 3-3(iv) of the Code of Civil Procedure);
- one of the following actions involving a company or any other association or foundation: if the association or foundation is a corporation and it is incorporated pursuant to the laws and regulations of Japan, or if the association or foundation is

not a corporation but its principal office or business office is located within Japan (article 3-3(v) of the Code of Civil Procedure); and

- an action for a tort: if the place where the tort occurs is within Japan (excluding if the consequences of a wrongful act committed in a foreign country have arisen within Japan but it would not ordinarily have been possible to foresee those consequences arising within Japan) (article 3-3(viii) of the Code of Civil Procedure).

However, even when the Japanese courts have jurisdiction over an action (except when an action is filed based on an agreement that only permits an action to be filed with the Japanese courts), the court may dismiss the whole or part of an action without prejudice if it finds that there are special circumstances because of which, if the Japanese courts were to conduct a trial and reach a judicial decision in the action, it would be inequitable to either party or prevent a fair and speedy trial, in consideration of the nature of the case, the degree of burden that the defendant would have to bear in responding to the action, the location of evidence and other circumstances (article 3-9 of the Code of Civil Procedure).

If the parties desire to have an international jurisdiction agreement be valid, it is formally required that the agreement be made in writing or by electromagnetic record (documentary nature) (article 3-7(2) and (3) of the Code of Civil Procedure). In addition, as substantive requirements, it is necessary that:

- the action relates to an action based on a certain legal relationship (article 3-7(2) of the Code of Civil Procedure);
- in the case of an agreement of exclusive jurisdiction of a foreign court, the court is not legally or factually unable to exercise jurisdiction (article 3-7(4)); and
- the action is not subject to international exclusive jurisdiction (articles 3-5 and 3-10).

In addition, a foreign judgment is recognised and enforced when:

- the court that made the judgment has jurisdiction;
- the losing defendant was serviced or appeared before the court in any event;
- the judgment is not contrary to the public policy (*ordre public*) of Japan; and
- mutuality is assured (article 118 of the Code of Civil Procedure).

Law stated - 31 January 2024

Litigation

42 What courts, procedures and remedies are available to suppliers and distribution partners to resolve disputes? Are foreign businesses restricted in their ability to make use of these courts and procedures? Can they expect fair treatment? To what extent can a litigant require disclosure of documents or testimony from an adverse party? What are the advantages and disadvantages to a foreign business of resolving disputes in your country's courts?

As there is no law that restricts the use of judicial resources on the basis of being a foreign company or individual, they can also enjoy the same judicial system as Japanese companies and individuals. In addition to court proceedings and arbitration, the following dispute resolution methods are available: issuance of demand for payment (article 382 of the Code of Civil Procedure), civil conciliation and various types of ADR. As Japan is ranked 12th in terms of fairness in judicial proceedings among various countries, foreign companies and individuals can expect fair judicial proceedings.

An order to the other party to disclose documents under compulsion is allowed only in court proceedings. A party may file a motion for an order to disclose documents in the other party's possession on the condition that certain requirements are met (article 220 of the Code of Civil Procedure), and if the other party violates the order, the petitioner's allegations regarding the statements in the documents are deemed true (articles 224(1) and (2)2 of the Code of Civil Procedure).

The advantage of going to trial is that the judgment by the court can be enforced (as Japan is a signatory to the New York Convention, the same advantage also exists in international arbitration awards). On the other hand, Japanese court cases are time-consuming (it is not uncommon for a single case to take up to several years to conclude). Also, although it is possible to use an interpreter at a trial in Japan, it would be a disadvantage that parties cannot receive court services in languages other than Japanese because all of the procedures (including oral proceedings and the submission of briefs and evidence) must be conducted in Japanese (article 74 of the Courts Act). Therefore, parties should choose international arbitration or other means if they are seeking a speedy resolution or multilingual legal services.

Law stated - 31 January 2024

Alternative dispute resolution

43 Will an agreement to mediate or arbitrate disputes be enforced in your jurisdiction? Are there any limitations on the terms of an agreement to arbitrate? What are the advantages and disadvantages for a foreign business of resolving disputes by arbitration in a dispute with a business partner in your country?

Parties may stipulate an arbitration clause, provided that it is written in the contract (article 13 of the Arbitration Act). In this case, a Japanese court in charge of the case shall dismiss the action without prejudice upon the petition of the defendant; provided, however, that this shall not apply to the following cases:

- if the arbitration agreement is not valid due to nullity, rescission or for any other reasons;
- if it is impossible to carry out arbitration proceedings based on an arbitration agreement; or
- if said petition was filed after the defendant presented oral arguments on the merits or made statements on the merits in preparatory proceedings in a court case (article 14 of the Arbitration Act).

An advantage includes that a foreign business can seek a rapid and final dispute resolution. As Japan is a state party to the New York Convention, foreign arbitral awards shall be found and enforced by Japanese courts unless one or more of the listed causes for refusal exists (articles 45 and 46 of the Arbitration Act). The causes for refusal are equivalent to those in article 36 of the UNCITRAL Model Law or article 5 of the New York Convention. The disadvantages, on the other hand, are that the costs are higher than in court settlements and the arbitrators' decisions are less predictable.

Law stated - 31 January 2024

UPDATE AND TRENDS

Key developments

44 Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? Are there any other current developments or trends that should be noted?

To create an environment in which freelancers can work with peace of mind, it was decided to establish effective and comprehensive guidelines for transactions between companies and freelancers to clarify the application of the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade, the Act against Delay in Payment of Subcontract Proceeds, etc to Subcontractors, and other labour-related acts, as well as to clarify problematic conducts based on these laws. In response, on 26 March 2021, the Cabinet Secretariat, the Fair Trade Commission, the Small and Medium Enterprise Agency and the Ministry of Health, Labour and Welfare jointly issued the Guidelines for Creating an Environment Where People Can Work on a Freelance Basis.

In addition, the Act on the Proper Treatment of Transactions between Certain Fiduciary Business Operators (Act on the Proper Treatment of Transactions between Freelances Business Operators) to protect freelancers was passed and enacted on 28 April 2023, and promulgated on 12 May 2023. The Act is expected to take effect within one year and six months of the date of promulgation. Under the Act, companies that outsource work to individual freelancers will be required to clearly state the terms and conditions of the outsourced work, pay remuneration within 60 days of the date of receipt of the service and establish a system to prevent harassment.

Law stated - 31 January 2024

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Summary

GOVERNING LAW AND CHOICE OF FORUM

UPDATE AND TRENDS

DIRECT DISTRIBUTION

Ownership structures

1 | May a foreign supplier establish its own entity to import and distribute its products in your jurisdiction?

A foreign supplier may establish its own entity in the Netherlands.

Law stated - 26 January 2024

2 | May a foreign supplier be a partial owner with a local company of the importer of its products?

A foreign supplier may be partial owner of a company that is importer of its products.

Law stated - 26 January 2024

3 | What types of business entities are best suited for an importer owned by a foreign supplier? How are they formed? What laws govern them?

The most common business entities in the Netherlands are the private limited liability company (Besloten Vennootschap, or BV) and the public limited liability company (Naamloze Vennootschap, or NV). Both entities have legal personality and provide limited liability for their shareholders. The managing directors run the business on a day-to-day basis. A BV or NV may appoint a supervisory board to monitor their board of directors (two-tier board) or the supervisors may be part of the board of directors (one-tier board). A BV or NV must be incorporated by notarial deed. All businesses active in the Netherlands must be registered in the Business Register of the Netherlands Chambers of Commerce.

On 1 January 2024, the Act on the Online incorporation of private limited liability companies came into force, implementing EU Directive 2019/1151 in the Netherlands. The act facilitates the establishment of a Dutch BV entirely online for EU nationals and EU legal entities, eliminating the need for physical presence at the notary's office and enabling the electronic signing of documents. The act further permits the drafting of the notarial deed and subsequent articles of association amendments in English, provided the initial incorporation was done through an electronically notarised English document without subsequent language changes.

Law stated - 26 January 2024

Restrictions

4 | Does your jurisdiction restrict foreign businesses from operating in the jurisdiction, or limit foreign investment in or ownership of domestic business entities?

The Netherlands has an investment screening regime that focuses solely on national security concerns. The new investment screening regime entered into force on 1 June 2023 and applies retroactively to investments completed after 8 September 2020. The regime is a general investment control regime that equally applies to non-EU, EU and Dutch investors. It primarily targets the investment's target rather than the investor's identity, and it aims to protect sensitive infrastructure and technologies. Otherwise, Dutch law does not restrict foreign businesses from operating in the Netherlands or limit foreign investment in or ownership of Dutch business entities.

Law stated - 26 January 2024

Equity interests

5 | May the foreign supplier own an equity interest in the local entity that distributes its products?

A foreign supplier may own an equity interest in a Dutch entity that distributes its products.

Law stated - 26 January 2024

Tax considerations

6 | What are the tax considerations for foreign suppliers and for the formation of an importer owned by a foreign supplier? What taxes are applicable to foreign businesses and individuals that operate in your jurisdiction or own interests in local businesses?

The main Dutch taxes levied from a foreign supplier or a Dutch limited liability company owned by a foreign supplier are corporate income tax, dividend withholding tax and personal income tax, VAT and import duties.

Dutch tax-resident companies are subject to corporate income tax based on their worldwide income. Non-Dutch tax-resident companies are subject to corporate income tax from certain Dutch sources, including Dutch permanent establishments or permanent representatives, shareholdings of at least 5 per cent in Dutch companies that cannot pass certain anti-abuse tests and other specific sources, including Dutch real estate, directorship services and the exploration of natural resources. The Dutch corporate income tax rate in 2024 is 19 per cent for taxable profits up to and including €200,000, and 25.8 per cent for taxable profits exceeding this amount.

Non-Dutch tax-resident individuals are subject to Dutch personal income tax on income from certain Dutch sources (box 1 income) or shareholdings of at least 5 per cent in Dutch companies (box 2 income).

Income tax in box 2 is levied at a rate of 24.5 per cent for taxable income up to and including €67,000 (€134,000 for tax partners) and 33 per cent for taxable income exceeding this amount in 2024. In many cases, if a Dutch BV is held by a qualifying foreign-resident legal entity, no tax is due upon distribution. In the case of a private individual shareholder, Dutch

taxation is mostly limited to the Dutch dividend withholding tax, which may be reduced by virtue of a tax treaty. The most efficient setup depends on all facts and circumstances, including local taxation in the home jurisdiction of the entrepreneur.

Furthermore, businesses are, in principle, required to file VAT returns and are entitled to a refund of (input) VAT charged, provided they are engaged in VAT-taxable transactions. These requirements also apply if the non-Dutch supplier has a fixed establishment for VAT purposes in the Netherlands.

Law stated - 26 January 2024

LOCAL DISTRIBUTORS AND COMMERCIAL AGENTS

Distribution relationships

7 What alternative distribution relationships are available to a supplier?

Freedom of contract exists in the Netherlands for commercial contracts in principle, meaning that parties have freedom to structure their relation as they wish. Distribution agreements, commercial agency or sales representatives agreements, and franchising are most common, although private label agreements, trademark licensing and joint ventures also occur.

Law stated - 26 January 2024

Legislation and regulators

8 What laws and government agencies regulate the relationship between a supplier and its distributor, agent or other representative? Are there industry self-regulatory constraints or other restrictions that may govern the distribution relationship?

Distribution agreements, under which the distributor acts as an independent reseller of the supplier, are governed by the common statutory rules on commercial contracts and a body of case law. There are no specific statutory rules on distribution agreements.

EU Directive 86/653/EEC of 18 December 1986 on the coordination of the laws of the member states relating to self-employed commercial agents as implemented in Title 7 of Book 7 of the Dutch Civil Code applies to commercial agents (ie, self-employed intermediaries who negotiate sale agreements on behalf of the supplier). The statutory rules include mandatory provisions on minimum notice periods for termination and a right to a goodwill indemnity due upon termination.

Since 1 January 2021, franchisors and franchisees must conform to the Dutch Franchise Act. From this date, franchise agreements with franchisees in the Netherlands must comply with the provisions of this Act as implemented in Title 16 of Book 7 of the Dutch Civil Code. The transition period of two years, within which existing franchise agreements had to be aligned with the new Act, expired on 1 January 2023. Agreements concluded after 1 January 2021 must comply with the new Act, including the mandatory provisions on the

pre-contractual four-week stand-still period, the goodwill indemnity due upon termination, and consent requirements for interim amendment of the franchise agreement or formula.

Law stated - 26 January 2024

Contract termination

9 Are there any restrictions on a supplier's right to terminate a distribution relationship without cause if permitted by contract? Is any specific cause required to terminate a distribution relationship? Do the answers differ for a decision not to renew the distribution relationship when the contract term expires?

Under Dutch law, agreements can be entered into for a fixed or indefinite period. Fixed-term agreements generally cannot be terminated prematurely, unless:

- otherwise agreed;
- this follows from reasonableness and fairness which – pursuant to Article 6:248 of the Dutch Civil Code – always applies to agreements concluded between the parties; or
- there are unforeseen circumstances as referred to in Article 6:258 of the Dutch Civil Code.

Agreements for an indefinite term are, in principle, always terminatable. However, reasonableness and fairness and the nature and content of the contract may imply that termination is only possible if a sufficiently serious ground for termination exists or provided a certain minimum notice period is observed or the termination is accompanied by an offer for compensation.

For distribution agreements, in the absence of an agreed notice period, the following rules of thumb regarding the notice period to be observed can be distilled from case law:

- for contracts of 0–2 years: three months' notice;
- for contracts of 2–4 years: six months' notice;
- for contracts of 4–10 years: 8–12 months' notice; and
- for contracts of 10–20 years: 1–2 years' notice.

However, what constitutes a reasonable notice period remains dependent on the circumstances of the case. The reasonable notice period serves to give the other party the opportunity to prepare for the moment when the agreement is actually terminated and to take the necessary measures, such as finding a new supplier. Other relevant circumstances for determining the length of the notice period may therefore include, inter alia, the extent to which investments have been made, the time needed to recoup them and the possibility of finding an alternative.

A commercial agency agreement for an indefinite term may in general also be terminated without cause if permitted by contract. If there is no notice period agreed upon, the notice period to be adhered to shall be four months for an agreement of no more than three years,

five months for an agreement with a duration of more than three years and six months for agreements with a duration of more than six years. A notice period contractually agreed upon must be at least one month for agreements with a duration of less than one year, two months for agreements with a duration of less than two years and three months for agreements with a duration of more than three years.

Law stated - 26 January 2024

10 Is any mandatory compensation or indemnity required to be paid in the event of a termination without cause or otherwise?

In general, a distributor has no right to compensation, indemnity or goodwill upon the regular termination of a distribution agreement. In certain circumstances, compensation for incurred costs may be due (eg, if the distributor with knowledge of the supplier has made investments with a view to the continuation of the agreement that cannot be recouped in the notice period). If the supplier terminates the agreement without cause and without applying the agreed period of notice, the supplier must normally pay compensation for damages to the distributor. Usually, this is an amount equivalent to the loss of profits due to premature termination.

Termination of a commercial agency agreement without cause in accordance with the contract generally does not cause a right to damages. However, in case of termination, the agent will be entitled to a goodwill indemnity if the principal will continue to benefit from the contract after termination. The amount of the indemnity may not exceed commissions over one year, calculated from the commercial agent's average annual remuneration over the preceding five years. Termination without cause and without observing the notice period entitles the agent – besides goodwill indemnity – to compensation unless the termination is a result of compelling reasons. The compensation normally equals the agent's remuneration, calculated based on the average amount of commission earned during the 12 months prior to the termination that would have been received by the agent if the notice period had been respected by the principal.

Law stated - 26 January 2024

Transfer of rights or ownership

11 Will your jurisdiction enforce a distribution contract provision prohibiting or restricting the transfer of the distribution rights to the supplier's products, all or part of the ownership of the distributor or agent, or the distributor or agent's business to a third party?

A non-transferability clause is in principle legally valid, binding and enforceable.

Law stated - 26 January 2024

REGULATION OF THE DISTRIBUTION RELATIONSHIP

Confidentiality agreements

12 Are there limitations on the extent to which your jurisdiction will enforce confidentiality provisions in distribution agreements?

In principle, there are no limitations regarding confidentiality clauses in distribution and commercial agency agreements.

Law stated - 26 January 2024

Competing products

13 Are restrictions on the distribution of competing products in distribution agreements enforceable, either during the term of the relationship or afterwards?

In the Netherlands, both EU and Dutch competition law apply. EU competition law applies to distribution agreements that have an effect on the EU internal market. Otherwise, the Dutch Competition Act, which is materially similar to EU competition law, applies.

Article 101(1) of the Treaty on the Functioning of the European Union (TFEU) prohibits all agreements and concerted practices that have as their object or effect the restriction or distortion of competition within the internal market, and in particular those that:

- directly or indirectly fix purchase or selling prices or any other trading conditions;
- limit or control production, markets, technical development or investment;
- share markets or sources of supply;
- apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; or
- make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

Article 101(3) TFEU allows for certain exemptions to the prohibition of article 101(1) TFEU. The EU Vertical Block Exemption Regulation (VBER), enacted under article 101(3) TFEU, allows certain exemptions from the prohibition of article 101(1) TFEU provided that the market share held by the supplier does not exceed 30 per cent of the relevant market on which it sells the contract goods or services and the market share held by the buyer does not exceed 30 per cent of the relevant market on which it purchases the contract goods or services. Above the market share threshold of 30 per cent, in principle no agreements that have as their object or effect the prevention, restriction or distortion of competition within the internal market are allowed.

The VBER defines ‘non-compete obligation’ as any direct or indirect obligation causing the distributor not to manufacture, purchase, sell or resell goods or services that compete with the contract goods or services, or any direct or indirect obligation on the distributor to purchase from the supplier or from another undertaking designated by the supplier more

than 80 per cent of distributor's total purchases of the contract goods or services and their substitutes on the relevant market. The exemption provided for by the VBER does not apply to:

1. direct or indirect non-compete obligations with an indefinite term or exceeding five years;
2. direct or indirect obligations for the distributor, after termination of the agreement, not to manufacture, purchase, sell or resell goods or services;
3. direct or indirect obligations causing the members of a selective distribution system not to sell the brands of particular competing suppliers;
4. any direct or indirect obligation causing a buyer of online intermediation services not to offer, sell or resell goods or services to end users under more favourable conditions via competing online intermediation services.

The restriction under (2) does not apply to any direct or indirect obligation causing the distributor, after termination of the agreement, not to manufacture, purchase, sell or resell goods or services provided all of the following conditions are fulfilled:

- the obligation relates to goods or services that compete with the contract goods or services;
- the obligation is limited to the premises and land from which the buyer has operated during the contract period;
- the obligation is indispensable to protect knowhow transferred by the supplier to the buyer; and
- the duration of the obligation is limited to a period of one year after termination of the agreement.

Law stated - 26 January 2024

Prices

14 | May a supplier control the prices at which its distribution partner resells its products? If not, how are these restrictions enforced?

EU and Dutch competition law prohibit both direct and indirect forms of price fixing, including fixing margins, setting a maximum discount, requiring that distributors obtain supplier's consent to revise their prices, the use of price reporting and monitoring systems putting pressure on distributors to deter discounting, warnings and similar practices. This prohibition does not apply to commercial agents or sales representatives, as these only intermediate between the supplier and the buyer and the sales agreement is executed directly between the supplier and the buyer.

The EU Commission and the Dutch Authority for Consumers and Markets are responsible for the administrative enforcement of the EU and Dutch competition rules and may levy fines. Depending on the circumstances, these fines may be substantial. In addition, buyers

that have been harmed by the fixed prices may file civil (follow-on) claims for compensation for the damage they suffered.

Law stated - 26 January 2024

15 May a supplier influence resale prices in other ways, such as suggesting resale prices, establishing a minimum advertised price policy, announcing it will not deal with customers who do not follow its pricing policy, or otherwise?

EU and Dutch competition law do allow recommended and maximum resale prices (the latter act as a ceiling for prices, thereby benefiting consumers).

Law stated - 26 January 2024

16 May a distribution contract specify that the supplier's price to the distributor will be no higher than its lowest price to other customers?

Most-favoured-nation (MFN) clauses have caused growing concern among competition authorities. In particular, price comparison tools and online marketplaces have been the target of a number of antitrust enforcement cases and market studies in Europe.

Two main types of MFN clauses have been considered by competition authorities across Europe:

- 'wide' MFNs: these typically require suppliers and retailers to publish on a price comparison tool or online marketplace the same or better price and conditions as those published on any other sales channel; and
- 'narrow' MFNs: these typically require suppliers and retailers to publish on a price comparison tool or online marketplace the same or better price and conditions as those published on their own (direct) website.

In respect of wide MFNs, European competition authorities have held that they soften competition between platforms, and impede innovation, entry and expansion by new platforms.

Outside the area of price comparison tools and online marketplaces, there seem in principle to be few objections to MFN clauses.

Law stated - 26 January 2024

17 Are there restrictions on a seller's ability to charge different prices to different customers, based on location, type of customer, quantities purchased, or otherwise?

Article 102 TFEU stipulates that any abuse of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market insofar as it may affect trade between EU member states. Such abuse may, in

particular, consist in applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage.

A supplier has a dominant position where it has the ability to behave independently of its competitors, customers, suppliers and the final consumer.

In the absence of a dominant position in the market, no obligation to charge uniform rates exists under European or Dutch competition rules.

Law stated - 26 January 2024

Geographic and customer restrictions

18 | May a supplier restrict the geographic areas or categories of customers to which its distribution partner resells? Are exclusive territories permitted? Is there a distinction between active sales efforts and passive sales that are not actively solicited, and how are those terms defined?

Provided that the market share held by the supplier and the distributor does not exceed 30 per cent of the relevant market on which they respectively sell and purchase the contract goods or services, the VBER allows the supplier to restrict:

- active sales by the distributor and its direct customers into a territory or to a customer group reserved to the supplier or allocated by the supplier exclusively to a maximum of five other exclusive distributors; and
- active or passive sales by the distributor and its customers to unauthorised distributors located in a territory where the supplier operates a selective distribution system for the contract goods or services.

The VBER defines active sales as actively targeting customers (eg, by visits, emails or through targeted advertising and promotion, offline or online). Passive sales are defined as sales made in response to unsolicited requests from individual customers.

A selective distribution system is a distribution system where the supplier undertakes to sell the contract goods or services, either directly or indirectly, only to distributors selected on the basis of specified criteria and where these distributors undertake not to sell such goods or services to unauthorised distributors within the territory reserved by the supplier to operate that system.

Law stated - 26 January 2024

19 | If geographic and customer restrictions are prohibited, how is this enforced?

The EU Commission and the Dutch Authority for Consumers and Markets are responsible for the administrative enforcement of the EU and Dutch competition rules and may levy fines. Depending on the circumstances, these fines may be substantial. Also, buyers that have been harmed by the fixed prices may file civil (follow-on) claims for compensation for the damage they suffered.

Law stated - 26 January 2024

Online sales

20 | May a supplier restrict or prohibit e-commerce sales by its distribution partners?

Provided that the market share held by the supplier and the distributor does not exceed 30 per cent of the relevant market on which they respectively sell and purchase the contract goods or services, the VBER allows restrictions of online sales and online advertising, provided that they do not, directly or indirectly, in isolation or in combination with other factors controlled by the parties, have the object of preventing the effective use of the internet by the distributor or its customers to sell the contract goods or services to particular territories or customers, or of preventing the use of an entire online advertising channel, such as price comparison services or search engine advertising.

Law stated - 26 January 2024

21 | May a distributor or agent restrict a supplier's sales through e-commerce intermediaries into the distribution partner's territory? May it require the supplier to obtain reports of such sales by territory and a payment of 'invasion fees' or similar amounts to the distribution partner?

A distributor or agent may restrict a supplier's sales through e-commerce intermediaries into the distribution partner's territory and may require the supplier to obtain reports of such sales by territory and a payment of 'invasion fees' or similar amounts to the distribution partner.

Law stated - 26 January 2024

Refusal to deal

22 | Under what circumstances may a supplier refuse to deal with particular customers? May a supplier restrict its distributor's ability to deal with particular customers?

A supplier may restrict its distributor's ability to deal with particular customers unless this would qualify as abuse of a dominant position within the internal market or in a substantial part of it as prohibited within the meaning of article 102 TFEU.

Law stated - 26 January 2024

Competition concerns

23 | Under what circumstances might a distribution or agency agreement be deemed a reportable transaction under merger control rules and require clearance by the competition authority? What standards would be used to evaluate such a transaction?

It is unlikely that a distribution or agency agreement would be classified as reportable transaction under the merger control rules.

Under Dutch and European competition laws, transactions are deemed reportable under the merger control rules if it is considered a concentration of businesses, encompassing mergers, acquisitions or joint ventures. Although it is theoretically plausible for an agency or distribution agreement to indirectly lead to the acquisition of control by the supplier or principal over the distributor or agent, such scenarios are highly uncommon. The inclusion of terms in distribution or agency agreements that permit the supplier or principal to acquire (indirect) control over the distributor or agent is unconventional. Furthermore, these clauses in the agreement might be invalidated by the Dutch courts for contravening the principle of reasonableness and fairness in contract law.

In the unlikely scenario that an agency or distribution agreement were to meet the criteria of a concentration of businesses, it would only be considered a reportable transaction if it surpasses a specified financial threshold. Under the Dutch Competition Act, reporting obligations arise only when the combined global revenue of the businesses involved exceeds €150 million, and at least two of these businesses generate revenues of at least €30 million in the Netherlands.

Law stated - 26 January 2024

24 Do your jurisdiction's antitrust or competition laws constrain the relationship between suppliers and their distribution partners in any other ways? How are any such laws enforced and by which agencies? Can private parties bring actions under antitrust or competition laws? What remedies are available?

The interaction between the distributor and supplier falls under the purview of Dutch and European antitrust regulations. In principle, distribution agreements are prohibited from incorporating clauses that intentionally or indirectly lead to the limitation of competition. Distribution agreements involving parties with market shares below 30 per cent that do not contain 'hardcore restrictions,' are exempt from antitrust regulations under the EU Vertical Block Exemption Regulation (VBER). Hardcore restrictions encompass clauses governing resale prices, market sharing and production restrictions.

Companies that act in violation of competition laws risk being fined by national competition authorities such as the Authority for Consumers & Markets (ACM) or the European Commission.

The Netherlands is widely regarded as a highly favourable jurisdiction for the private enforcement of competition law. In private enforcement of competition law, it is private entities that invoke competition law in disputes or legal proceedings. This typically involves cases seeking damages, where the claiming party alleges to have suffered harm due to a violation of competition rules by other parties. For instance, this may occur when a group of businesses forms a price cartel and, over an extended period, charges consumers or buyers an excessively high price for their products. Consumers harmed by a violation of competition rules may file a claim for damages in court as a collective in a so-called class action.

The antitrust and competition laws do not extend to the relationship between the agent and principal.

Law stated - 26 January 2024

Parallel imports

25 Are there ways in which a distributor or agent can prevent parallel or 'grey market' imports into its territory of the supplier's products?

Within the EU and EEA, the doctrine of exhaustion of intellectual property rights applies. This means that once the intellectual property owner has placed the goods up for sale (either itself or has given consent for another to sell the products within the EU and EEA), in relation to these goods its rights are exhausted, and it cannot prevent others from importing the goods and reselling them in any other EU member state. This leaves the possibility that the intellectual property owner may oppose importing goods incorporating its intellectual property rights into the EU and EEA from third countries.

Law stated - 26 January 2024

Advertising

26 What restrictions exist on the ability of a supplier or distributor to advertise and market the products it sells? May a supplier pass all or part of its cost of advertising on to its distribution partners or require them to share in its cost of advertising?

A supplier is free to pass all or part of its cost of advertising on to its distribution partners or require them to share in its cost of advertising.

Law stated - 26 January 2024

Intellectual property

27 How may a supplier safeguard its intellectual property from infringement by its distribution partners and by third parties? Are technology transfer agreements common?

Patents, trademarks and designs may be protected by registration in the relevant national, Benelux or EU registers. Copyrights are protected in the Netherlands under the Berne Convention for the Protection of Literary and Artistic Works. A supplier may safeguard its intellectual property rights (including trade secrets and know-how) from infringement by its distribution partners by making appropriate contractual arrangements. EU Directive 2004/48/EC on the enforcement of intellectual property rights as implemented in the Dutch Code on Civil Procedure provides for effective tools to combat the infringement of intellectual property rights by third parties. This Directive provides a minimum set of measures, procedures and remedies allowing effective civil enforcement of intellectual

property rights across the EU, ensuring a standardised level of protection throughout the internal market. Technology transfer agreements are common.

Law stated - 26 January 2024

Consumer protection

28 | What consumer protection laws are relevant to a supplier or distributor?

Most consumer protection laws consist of EU legislation implemented in Dutch law. EU Directive 1999/44/EC on certain aspects of the sale of consumer goods and associated guarantees was implemented in Book 7 of the Dutch Civil Code. The most important rule of this Directive is that the seller must deliver goods to the consumer that are in conformity with the contract of sale. Consumer goods are presumed to be in conformity with the contract if they:

- comply with the description given by the seller;
- are fit for any particular purpose for which the consumer requires them and which was made known to the seller at the time of conclusion of the contract and which the seller has accepted; and
- are fit for the purposes for which goods of the same type are normally used.

EU Directive 93/13/EEC on unfair terms in consumer contracts, as implemented in Book 6 of the Dutch Civil Code, has introduced a blacklist of that which may not be used in contracts with consumers and a grey list of terms that are presumed to be unreasonable. The EU Unfair Commercial Practices Directive defines unfair business-to-consumer commercial practices that are prohibited in the European Union. In particular, misleading commercial practices (by action or omission) and aggressive commercial practices are considered unfair. Further, restrictions exist for the (tele)marketing of products (eg, a ban on unsolicited telesales).

Law stated - 26 January 2024

Product recalls

29 | Briefly describe any legal requirements regarding recalls of distributed products. May the distribution agreement delineate which party is responsible for carrying out and bearing the cost of a recall?

Product recalls are aimed at preventing unsafe products from entering or remaining on the market. The required measures will vary from recall to recall. In some cases, a single warning to intermediaries will suffice, but often a producer will be confronted with a diverse range of measures to be taken, aimed at preventing further use and recall of the product. A product recall in general involves significant costs (eg, costs for investigating the extent and cause of the product's unsafety, replacement costs and the retrieval and destruction of these unsafe products), as well as lost sales and damages, and reputational damage.

In general, parties are free to delineate which party is responsible for bearing the cost of a recall.

Law stated - 26 January 2024

Warranties

30 To what extent may a supplier limit the warranties it provides to its distribution partners and to what extent can both limit the warranties provided to their downstream customers?

The supplier is, in principle, free to limit the warranties it provides to its distribution partners. In case of serious fault, wilful misconduct or gross negligence a contractual limitation of warranties could be set aside by the Dutch court. The warranties to downstream customers may be equally limited, except for the statutory warranties to consumers.

Law stated - 26 January 2024

Data transfers

31 Are there restrictions on the exchange of information between a supplier and its distribution partners about the customers and end users of their products? Who owns such information and what data protection or privacy regulations are applicable?

Data about the distributor's customers and end-users are in principle owned by the distributor. The EU General Data Protection Regulation (GDPR) applies to all processing of personal data (ie, information relating to an identified or identifiable natural person (data subject)). Exchange of personal data is only allowed to the extent the data subject has given consent or this is necessary for:

- the performance of a contract to which the data subject is party or to take steps at the request of the data subject prior to entering into a contract;
- for compliance with a legal obligation;
- to protect the vital interests of the data subject or of another natural person; or
- for the purposes of the legitimate interests pursued by the controller or by a third party, except where such interests are overridden by interests of the data subject that require the protection of personal data.

No special requirements apply to data transfers from the Netherlands to other EEA countries. Transfers of personal data to countries outside the EEA, however, require – with a few exceptions – either a decision of the European Commission that the destination country ensures an adequate level of protection (this is the case for the United Kingdom, Switzerland, Canada, Israel and Japan, for example), or appropriate safeguards to protect the data subjects' rights (such as the Commission's standard contractual clauses (SCCs) or binding corporate rules approved by a supervisory authority).

On 16 July 2020, the Court of Justice of the European Union (CJEU) issued its decision in *Data Protection Commissioner v Facebook Ireland, Maximillian Schrems* (*Schrems II*-), invalidating the EU–US Privacy Shield Framework, which provided a mechanism for transferring personal data from the European Union to the United States.

On 25 March 2022, the European Commission and the United States announced an agreement in principle on a new Trans-Atlantic Data Privacy Framework. On 7 October 2022, President Biden signed the Executive Order On Enhancing Safeguards For United States Signals Intelligence Activities, outlining the implementation steps the United States will undertake in furtherance of the EU–US Data Privacy Framework (DPF). On 10 July 2023, the European Commission formally adopted a new adequacy decision on the EU-US Data Privacy Framework. The decision concludes that the United States ensures an adequate level of protection – comparable to that of the European Union – for personal data transferred from the EU to companies in the United States under the new framework. On the basis of the new adequacy decision, personal data can flow safely from the EU to US companies participating in the Framework, without having to put in place additional data protection safeguards.

Schrems II also dealt with SCCs. The SCCs are a standard set of contractual terms and conditions that require both the exporter and importer of personal data to offer an equal level of protection for EU personal data. The CJEU decided that, while SCCs are still valid, they require additional work. Companies must ensure that the recipient country has equivalent data protection to that of the EU. They cannot rely on SCCs alone.

On 4 June 2021, the European Commission issued modernised SCCs. These modernised SCCs replace the three sets of SCCs adopted under the previous Data Protection Directive 95/46. It is no longer possible to conclude contracts incorporating these earlier sets of SCCs and on 27 December 2022, the grace period for using contracts incorporating these earlier sets of SCCs expired.

Law stated - 26 January 2024

32 What requirements apply to suppliers and their distribution partners with respect to protecting the security of customer data they hold?

The GDPR requires that personal data shall be retained no longer than is necessary for the purposes for which the personal data are processed and are processed in a manner that ensures appropriate security of the personal data, using appropriate technical or organisational measures.

Law stated - 26 January 2024

Employment issues

33 May a supplier approve or reject the individuals who manage the distribution partner's business, or terminate the relationship if not satisfied with the management?

The distribution partner is an independent party and, as such, a supplier is not entitled to control who is employed by the distributor, nor is a supplier able to terminate the employment agreement between a distributor and an employee. Theoretically, while it is not considered common practice in the Netherlands, it is possible to agree that the supplier may influence (in certain scenarios) hiring and firing decisions with regard to (key) personnel. However, mandatory Dutch employment law would still apply, including the regulations regarding termination of employment.

Law stated - 26 January 2024

34 Are there circumstances under which a distributor or agent, or its employees, would be treated as an employee of the supplier, and what are the consequences of such treatment? How can a supplier protect against responsibility for potential violations of labour and employment laws by its distribution partners?

Under Dutch employment law, an agreement qualifies as an employment agreement if the following criteria as laid down in article 7:610 of the Dutch Civil Code are met: personal performance of work under the authority of the company, in return for remuneration. If an agreement qualifies as an employment agreement, (mandatory) Dutch employment law and regulations apply.

If an individual claims in court that their agreement with a company qualifies as an employment agreement, a judge will assess that claim based on all relevant circumstances of the case. This includes not only the wording of the agreement, but also the way in which the parties execute the agreement in practice. If the agreement qualifies as an employment agreement, all aspects of (mandatory) Dutch employment law (retroactively) apply to the agreement. This includes the entitlement to holiday pay and payment during sickness, as well as the applicability of the mandatory regulations regarding termination of employment and payment of statutory severance upon termination of the employment agreement. The qualification of the agreement as an employment agreement may also have significant tax consequences.

Law stated - 26 January 2024

Commission payments

35 Is the payment of commission to a commercial agent regulated?

In general, the commercial agent and principal are free to agree on the commission due. In the absence of a contractual arrangement, article 7:431 sub 1 Dutch Civil Code stipulates that the agent is entitled to commission for contracts concluded during the term of the commercial agency agreement if these contracts:

- have been concluded mainly as a result of the activities of the agent;
- have been concluded with a third party previously put forward by the agent for conclusion of a similar contract; or
-

have been concluded with third parties belonging to a specific group of customers or residing in a specific geographical area that has been assigned to the agent, provided that the agent and principal have not explicitly agreed to the non-exclusivity of said group or geographical area.

Law stated - 26 January 2024

Good faith and fair dealing

36 | What good faith and fair dealing requirements apply to distribution relationships?

There are no specific good faith and fair dealing requirements concerning distribution agreements and commercial agency agreements. Nevertheless, the general rules of Dutch contract law (such as the standard of reasonableness and fairness stipulated in articles 6:2 and 6:248 Dutch Civil Code) are applicable to distribution agreements and commercial agency agreements.

Law stated - 26 January 2024

Registration of agreements

37 | Are there laws requiring that distribution agreements or intellectual property licence agreements be registered with or approved by any government agency?

No laws require registration or approval of distribution agreements or intellectual property licence agreements by any government agency exist. However, registration of a licence agreement with the relevant patent, trademark or design register has the advantage that third parties must respect the licence.

Law stated - 26 January 2024

Anti-corruption rules

38 | To what extent are anti-bribery or anti-corruption laws applicable to relationships between suppliers and their distribution partners?

Bribery in commercial relations is prohibited under article 328ter of the Dutch Criminal Code.Employees accepting or requesting gifts, promises or services in response to what they have done or omitted to do or will do or omit to do in breach of their duty in their employment or in the performance of their duty, are punishable with imprisonment up to four years or a fine with a maximum of €103,000. The same sanctions apply to the person offering the gift, promise or service. Acting in breach of duty shall in any case include concealing from the employer or principal, contrary to good faith, the acceptance or solicitation of a gift, promise or service.

Law stated - 26 January 2024

Prohibited and mandatory contractual provisions

39 Are there any other restrictions on provisions in distribution contracts or limitations on their enforceability? Are there any mandatory provisions? Are there any provisions that local law will deem included even if absent?

Distribution agreements may not violate public order and good morals and must comply with EU and Dutch competition laws, but in principle no other restrictions exist.

Law stated - 26 January 2024

GOVERNING LAW AND CHOICE OF FORUM

Choice of law

40 Are there restrictions on the parties' contractual choice of a country's law to govern a distribution contract?

The applicable law on agency contracts is determined by the Hague Convention of 14 March 1978 on the Law Applicable to Agency. The applicable law regarding distribution agreements is determined by the EU Rome I Regulation (Regulation (EC) No 593/2008). Both the Rome I Regulation and the Hague Agency Convention provide that parties may choose which law applies. However, they may not evade the protective provisions of EU law by choosing the law of a non-member state. If no choice of law is made, the law of the country where the commercial agent or distributor has its habitual residence applies. Under Dutch Private International Law, there is an exception for agency contracts: if the agent mainly operates in the country where the principal resides, the law of that country applies.

Law stated - 26 January 2024

Choice of forum

41 Are there restrictions on the parties' contractual choice of courts or arbitration tribunals, whether within or outside your jurisdiction, to resolve contractual disputes?

Under the EU Brussels I bis Regulation and the Dutch Code on Civil Procedure, parties are in general free to make a contractual choice of courts or arbitration tribunals, whether within or outside the Netherlands.

Law stated - 26 January 2024

Litigation

42

> What courts, procedures and remedies are available to suppliers and distribution partners to resolve disputes? Are foreign businesses restricted in their ability to make use of these courts and procedures? Can they expect fair treatment? To what extent can a litigant require disclosure of documents or testimony from an adverse party? What are the advantages and disadvantages to a foreign business of resolving disputes in your country's courts?

Dutch courts have jurisdiction if the defendant is domiciled in the Netherlands or if the parties have elected a Dutch court to judge any disputes arising from their legal relationship.

In the Netherlands, there are two main types of civil proceedings: proceedings for ordinary civil suits initiated by summons and less formal proceedings initiated by an application for suits on specific topics (eg, employment, leases, family, and certain corporate matters). In general, for commercial disputes the proceedings by summons is used. In first instance, disputes are resolved by the competent District Court. It is possible to file an appeal with the competent Appeal Court. From judgments of the Appeal Court, appeal is possible to the Dutch Supreme Court. The Supreme Court does not examine the facts but purely observes whether the court of appeal has correctly applied the law.

A party with a sufficiently urgent interest in injunctive relief may initiate summary proceedings. The requested injunction will be granted if it is sufficiently likely that the court in the proceedings on the merits will come to an identical decision. The injunction applies until a decision is reached in the proceedings on the merits. The range of possible injunctions is broad. For example, the court may order the prejudgment attachments to be lifted, the execution of a ruling to be suspended or an agreement to be performed.

There exist no restrictions on foreign businesses' ability to make use of these courts and procedures, except that upon request of the other party a foreign business may be required first to provide security for the costs of the proceedings and damages which they could be sentenced to pay (the *cautio iudicatum solvi*). The *cautio iudicatum solvi* does not apply if this is excluded by treaty (eg The Hague Convention on Civil Procedure and the Dutch American Friendship Treaty).

In the Netherlands, there is no jury system. The judiciary is independent and judges can only be removed from office for malfeasance or incapacity. The Netherlands is a small country with an open economy, and the Dutch courts are accustomed to dealing with foreign parties; foreign businesses can expect fair treatment.

In principle, court hearings in civil cases are public. Under special circumstances, the court may decide to conduct hearings behind closed doors – for example, in case of a dispute about trade secrets or if public policy or morality so demands.

The judge has a passive role in determining the scope of the dispute; this is determined by the parties and the claims they bring before the court.

It is up to the parties to sufficiently substantiate their claims using any legal means necessary. In civil lawsuits, all forms of evidence are permissible unless the law provides otherwise. No discovery procedures comparable to those in common law systems exist. Under article 843a of the Dutch Code on Civil Procedure parties may request inspections or copies of certain documents (production of exhibits) from the other party. Cumulative conditions must be satisfied for the request for the production of exhibits. The court can

refuse the request pursuant to substantial reasons or if a proper administration of justice can be guaranteed without the requested information.

There are various awards available to a successful claimant (eg, specific performance, damages, an application for an order or injunction, a declaratory decision, rescission or annulment). Final judgments or judgments with immediate effect may be enforced after being served by the bailiff.

In principle, parties must pay their own litigation costs. However, the losing party is usually ordered to pay the litigation costs of the prevailing party. The costs that the losing party must pay are based on fixed amounts for certain standard activities but are also dependent on the value of the claim. The actual litigation costs incurred by the prevailing party are often not fully covered by the amount awarded.

Court litigation in the Netherlands has the advantages that legal proceedings tend to be time and cost efficient and that the Dutch courts are accustomed to deal with international disputes. In the event recourse is sought outside the EU and EEA, a judgment of a Dutch court may have little use due to the absence of treaties on the mutual recognition and enforcement of judicial awards with most countries outside the EU and EEA.

Law stated - 26 January 2024

Alternative dispute resolution

43 Will an agreement to mediate or arbitrate disputes be enforced in your jurisdiction? Are there any limitations on the terms of an agreement to arbitrate? What are the advantages and disadvantages for a foreign business of resolving disputes by arbitration in a dispute with a business partner in your country?

If the parties have executed an arbitration agreement in which the place of arbitration is in the Netherlands, the arbitration is subject to the Dutch Arbitration Act. There are in principle no limitations (such as the arbitration tribunal, the location of the arbitration or the language of the arbitration) on the terms of an agreement to arbitrate, except that matters not at the discretion of the parties (eg, matters of public policy, criminal law and intellectual property law) cannot be dealt with in arbitration.

An appeal against an arbitral award cannot be lodged with the Dutch civil court. However, arbitral appeal is possible if the parties have expressly included this in the arbitration agreement. In specific circumstances and on specific grounds it is possible to revoke or set aside an arbitral award.

The party that wants to enforce the arbitral award must obtain prior judicial leave (exequatur) from the provisional relief judge of the competent Dutch district court. The Netherlands is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958. Therefore, the Netherlands cannot impose more onerous conditions for the recognition or enforcement of Convention awards than are imposed on the recognition or enforcement of arbitral awards rendered under Dutch law.

Given the absence of treaties on the mutual recognition and enforcement of judicial awards with most countries outside the EU and EEA, arbitration is the preferred option for dispute resolution if one of the parties resides outside the EU and EEA.

There are no specific statutory rules on mediation. The parties are free to agree to mediation. Mediation clauses entered into by the parties constitute legally binding contracts. However, the legal implications of a mediation clause are very limited. It has been established by decisions of the Dutch Supreme Court that parties who have agreed to resolve a dispute by way of mediation will always be free subsequently to decline to mediate. Consequently, a mediation clause does not have an impact on the jurisdiction of national courts to hear the dispute.

A mediator is appointed by the parties prior to or pending legal proceedings before an arbitral tribunal or national courts. Parties may also be assisted by an institution that facilitates mediation proceedings to choose a mediator. When court proceedings are pending, a Dutch court can refer the dispute to mediation in accordance with the 'mediation alongside litigation' procedure.

Any settlement agreement resulting from a mediation process is considered to be a legally binding agreement. However, the settlement agreement is not (directly) enforceable until established as such in court.

Law stated - 26 January 2024

UPDATE AND TRENDS

Key developments

44 Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? Are there any other current developments or trends that should be noted?

Data protection developments

The European Data Governance Act 2022 (the DGA), a central part of the European strategy for data, entered into force on 24 September 2023. The act focuses on 'data intermediaries' (such as data marketplaces) and aims to make greater data available and facilitate data sharing across sectors within the European Union in order to leverage the economic potential of data for the benefit of European citizens and businesses. The DGA encompasses both personal and non-personal data.

The DGA is complemented by the European Data Act (the Data Act), another component of the European strategy for data. On 11 January 2024, the Data Act entered into force, with the main provisions to be fully applicable from 12 September 2025. The Data Act seeks to establish a single market for industrial data by imposing new obligations for cloud service providers on access and the use of data generated through the use of connected products (Internet of Things) across all economic sectors, as well as facilitating customers to switch to other cloud providers.

ESG Developments for suppliers to consider

Pending formal adaptation by the European Council and the European Parliament, the Corporate Sustainability Due Diligence Directive (CSDDD), aims to enhance environment and human rights protection within the EU and globally. Companies falling under its scope are required to conduct due diligence on their operations and of their suppliers to identify, prevent and mitigate adverse impacts on human rights and the environment. Recently, on 14 December 2023, the European Council and the European Parliament reached a provisional agreement that outlines the scope of the directive, clarifies liabilities for non-compliant companies, better defines the different penalties, and completes the list of rights and prohibitions that companies must adhere to. The CSDDD proposal is still in the legislative pipeline, and further changes are anticipated before the regulation is finalised.

The Dutch bill on the Responsible and Sustainable International Corporate Act (the Bill) is pending before the Dutch House of Representatives. It introduces a broad duty of care applicable to Dutch entities, establishing a general due diligence obligation for all Dutch legal entities that are aware or reasonably should be aware that their activities or those of their business relations may have adverse effects on human rights, labour rights or the environment in a country outside the Netherlands. In addition, the Bill mandates that specific large companies conduct due diligence throughout their entire supply chains, encompassing all activities, business, conduct of their business relations, such as suppliers, and necessitates the submission of accompanying reports on their policies and measures for due diligence.

Law stated - 26 January 2024

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Summary

GOVERNING LAW AND CHOICE OF FORUM

UPDATE AND TRENDS

DIRECT DISTRIBUTION

Ownership structures

1 | May a foreign supplier establish its own entity to import and distribute its products in your jurisdiction?

Generally, yes, unless the supplier's country, the supplier itself or its principal is the subject of a trade embargo or sanctions. As at December 2023, the countries on the embargo list are the Crimea region of Ukraine, Cuba, Iran, North Korea and Syria. In addition, there are sanctions affecting specified persons and categories of persons relating to the following countries or areas: Afghanistan, the Balkans, Belarus, Burundi, the Central African Republic, the Democratic Republic of the Congo, Iraq, Lebanon, Libya, Mali, Nicaragua, Russia (including some persons in Ukraine and the Crimea region of Ukraine), Somalia, South Sudan, Venezuela, Yemen and Zimbabwe. Russia is also subject to import bans on certain products. The lists of embargoed countries and sanctioned individuals and entities are maintained by the Office of Foreign Assets Control (OFAC) of the US Department of Treasury. For details, see the OFAC sanctions page.

There are also certain industries in which foreign ownership is restricted or regulated, either nationally or by certain states, such as defence contracting, banking and alcoholic beverages.

Law stated - 18 January 2024

2 | May a foreign supplier be a partial owner with a local company of the importer of its products?

Generally yes, subject to embargoes, sanctions and certain industries. As at December 2023, the countries on the embargo list are the Crimea region of Ukraine, Cuba, Iran, North Korea and Syria. In addition, there are sanctions affecting specified persons and categories of persons relating to the following countries or areas: Afghanistan, the Balkans, Belarus, Burundi, the Central African Republic, the Democratic Republic of the Congo, Iraq, Lebanon, Libya, Mali, Nicaragua, Russia (including some persons in Ukraine and the Crimea region of Ukraine), Somalia, South Sudan, Venezuela, Yemen and Zimbabwe. Russia is also subject to import bans on certain products. The lists of embargoed countries and sanctioned individuals and entities are maintained by the OFAC of the US Department of Treasury. For details, see the OFAC sanctions page. There are also certain industries in which foreign ownership is restricted or regulated, either nationally or by certain states, such as defence contracting, banking and alcoholic beverages.

Law stated - 18 January 2024

3 | What types of business entities are best suited for an importer owned by a foreign supplier? How are they formed? What laws govern them?

Any importer, whether foreign-owned or not, should operate through a form of entity whose liability is limited to the assets of the entity to minimise the risk of the owners' assets being available to satisfy claims for the activities of the business. The most common of these are the corporation and the limited liability company (LLC). These are formed under state law by filing documents with the chosen US state, and that state's laws will govern the entity as to its internal governance and the relationships among the owners and the entity.

While LLCs are generally more flexible with respect to governance, economic structure and corporate formalities, for a foreign parent a corporation will often be preferable from a tax perspective, depending on the applicable tax treaties between the United States and the foreign parent's home jurisdiction, as well as the tax laws of that jurisdiction. If an entity treated as a corporation for US tax purposes is preferred, the entity can be formed either as a corporation or a limited partnership or LLC that files an election with the US Internal Revenue Service to be classified as a corporation for US tax purposes.

Law stated - 18 January 2024

Restrictions

4 Does your jurisdiction restrict foreign businesses from operating in the jurisdiction, or limit foreign investment in or ownership of domestic business entities?

Generally, there are no restrictions on where the foreign supplier operates within the United States or on ownership of domestic business entities. Restrictions on ownership exist in certain industries and in circumstances where US embargoes or sanctions apply.

The foreign supplier may need to qualify to do business in states where it is doing business. This is a simple registration under which a business entity from outside of the state agrees to be subject to the jurisdiction of the state and appoints an agent for service of legal process in the state. Whether qualification is required depends on a fact-based assessment of whether the company is 'doing business' in that state, as that state defines it. The consequences of not qualifying when required to do so are usually not serious, but the company will not have access to the courts of the state until it has qualified.

Law stated - 18 January 2024

Equity interests

5 May the foreign supplier own an equity interest in the local entity that distributes its products?

Yes, unless the supplier's country, the supplier itself or the supplier's principal is the subject of a trade embargo or sanctions. The lists of embargoed countries and sanctioned individuals and entities are maintained by the OFAC of the US Department of Treasury. For details, see the OFAC sanctions page.

There are also certain industries in which foreign ownership is restricted or regulated, either nationally or by certain states, such as defence contracting, banking, and alcoholic beverages.

Law stated - 18 January 2024

Tax considerations

6 What are the tax considerations for foreign suppliers and for the formation of an importer owned by a foreign supplier? What taxes are applicable to foreign businesses and individuals that operate in your jurisdiction or own interests in local businesses?

Foreign businesses and individuals are generally subject to federal (national US) income tax on their taxable income that is deemed to be 'effectively connected' with a US trade or business (effectively connected income (ECI)) at the normal rates applicable to US persons. Non-US persons must file a US income tax return to report this income and may deduct the expenses of the US business. A foreign corporation that has ECI is subject to an additional 30 per cent US branch profits tax on its after-tax net income. A foreign person is also subject to a 30 per cent US withholding tax on US-source 'fixed or determinable annual or periodic' income, which generally includes dividend income.

If a foreign entity provides services in the US, and those services are performed by employees of the foreign entity, the foreign entity will be engaged in a US business. This means that the foreign entity will have to file a US tax return and report and pay tax on its ECI from those services. Also, if the foreign entity invested in a US operating business directly or through an entity treated as a partnership for US tax purposes, the foreign entity itself would be required to file a US tax return and pay taxes on its share of any ECI generated by the operating business. In addition, on a sale of the partnership interests in such an operating business by the foreign entity, the purchaser would be required to withhold 10 per cent of the amount realised on the sale or exchange by the foreign entity under US tax law.

To alleviate both the implications of having to file a tax return in the US and the payment of the branch profits tax, the foreign entity could establish a US subsidiary corporation (or LLC, which elects to be classified as a corporation for US tax purposes) to employ the individuals who will perform services in the US or to hold the foreign parent's investment in a US operating business. The US subsidiary would file a US tax return and would be subject to US tax at regular US corporate income tax rates on the income generated by the US business, less its business expenses. If the US subsidiary makes any distributions to the foreign parent out of its earnings and profits during the time that it was operating or holding an investment in a business in the US, the distributions would be subject to a US dividend withholding tax at a rate of 30 per cent (or any lesser rate provided in an applicable income tax treaty between the US and the foreign entity's home country). When the US subsidiary sells its US business or its investment in a US business, the US subsidiary would be subject to US tax on any net gain realised on the sale. However, it could then fully liquidate and distribute the proceeds from its business or its investment to its foreign parent, and that liquidating distribution would not be subject to US withholding taxes. Accordingly, a foreign business or individual can avoid a second level of US tax (ie,

branch profits tax or dividend withholding tax) on its US business or its investment in a US business if it makes its investment through a wholly owned US corporation (or LLC, which elects to be classified as a corporation for US tax purposes), and the US corporation does not make any distributions to the foreign parent until it fully liquidates.

However, depending on the tax rules of the jurisdiction where the foreign business is located and the structure of the foreign company, it may be preferable to structure the US subsidiary as a US partnership that elects to be treated as a corporation for US tax purposes. This structure will have the same US tax benefits of investment through a US corporation as discussed above and may also allow the investing company or its equity owners to receive a tax credit in its local jurisdiction for the US corporate taxes paid by the US subsidiary. Often, income tax treaties between the US and other countries can affect the preferred structure and offer opportunities to reduce the total tax burden from a foreign business's US operations.

Law stated - 18 January 2024

LOCAL DISTRIBUTORS AND COMMERCIAL AGENTS

Distribution relationships

7 | What alternative distribution relationships are available to a supplier?

The options for distribution, for the most part, are limited only by the creativity of the businesspeople structuring the relationship. The most common are discussed below.

Direct distribution

Distribution by the foreign supplier using its own employees or through a subsidiary.

Commercial agents and sales representatives

The agent does not purchase or take title to the goods, but rather sells them on behalf of the foreign supplier and receives a commission. Matters such as who actually delivers the product, who generates the invoice, how risk of non-payment is shared and other logistical matters may be addressed by contract, together with a definition of each party's duties and how the relationship may be terminated.

Independent distributors

The supplier contracts with an independent distributor that buys goods from the supplier, taking title to those goods, and resells them at a profit to its own customers. The details of the relationship, including the responsibilities of each side and the parties' rights to terminate, are defined by contract.

Franchising

Franchising, under the typical definition, amounts to the use of independent distributors who: (1) are licensed to use the supplier's trademarks, either in the business name or in the products sold; (2) are required to follow a prescribed marketing plan or method of operation; and (3) pay a franchise fee to the supplier. (Under New York law, a franchise exists when either of the first two elements is present, and a franchise fee is paid.) The specific definition and the consequences of being deemed a franchise vary from state to state. In many US states, franchises are regulated in one, or both, of two ways. First, many states and the Federal Trade Commission (FTC) require disclosure documents in a prescribed format to be provided to the prospective franchisee and, in some states, to be registered with the state. Second, some states regulate the substance of the relationship between the franchisor and the franchisee in various ways, most notably by restricting the franchisor's right to terminate or not renew the relationship except for statutorily defined good cause, often requiring a specified period in which the franchisee may cure any default. States that regulate franchising often require franchisors to submit to jurisdiction and appoint an agent for service of process in the franchisee's state.

Joint ventures

A joint venture can be established by a foreign supplier with its distribution partner in the US, whether the partner is an agent, distributor or franchisee, by having the local distribution entity owned in part by the supplier, directly or through a subsidiary, or through another form of sharing of profits and expenses. An ownership interest can provide greater control through ownership rights and representation on a board of directors or management committee.

Licensing of manufacturing rights

A foreign supplier may license a US manufacturer to use its intellectual property – patent, copyright, trademark or trade secrets – to make its products locally and sell them. While all the implications of licensing intellectual property are beyond the scope of this chapter, care must be taken by the licensor to maintain quality control over the finished product and the use of the intellectual property. Failure to provide for adequate licensor quality control, called a 'naked license,' can not only put the brand equity at risk, but it also risks the loss of trademark protection.

Private label

Distribution of products under a private label amounts to a reverse licensing arrangement where a US distributor or retailer distributes the foreign supplier's products under the US business's own trademark. In essence, the supplier gives up its own brand name in exchange for the distribution strength of its US partner, with the supplier reaping no enhanced brand value. Control over sales, distribution, marketing and advertising are in the hands of the local brand owner, resulting in negligible distribution costs to the supplier and virtually no control, save perhaps for sales and performance benchmarks in the contract, with benefits to the supplier limited to its profits on sales of the product.

Law stated - 18 January 2024

Legislation and regulators

8 What laws and government agencies regulate the relationship between a supplier and its distributor, agent or other representative? Are there industry self-regulatory constraints or other restrictions that may govern the distribution relationship?

By and large, the relationship between the supplier and its distribution partner is governed by contract, which the parties are free to structure as they wish. Notable exceptions are: (1) business franchises, which are regulated by federal disclosure requirements and by various state disclosure, registration and relationship laws; and (2) federal and state laws governing certain industries, which can regulate the right of a supplier to terminate a distribution relationship, among other aspects of the relationship. There are federal laws governing automobile dealers and petroleum products retailers (petrol stations). Many states have similar laws for those industries, and there are state laws governing beer, wine, and spirits, farm equipment and occasionally other industries. (Understanding the laws and regulations governing businesses and individuals in the US is complicated by the fact that there is regulation at the national, federal level, and at the state level by each of the 50 US states, Washington, DC, and US territories and possessions, such as Puerto Rico, the US Virgin Islands and Guam.)

Many industries have adopted codes of conduct applicable to companies in the industry, which suppliers often incorporate into their distribution agreements so they become part of the contract. (Some companies incorporate similar codes of conduct that they have adopted individually.) Such codes of conduct that have been incorporated into contracts by reference are enforceable just like any other contract provision.

Law stated - 18 January 2024

Contract termination

9 Are there any restrictions on a supplier's right to terminate a distribution relationship without cause if permitted by contract? Is any specific cause required to terminate a distribution relationship? Do the answers differ for a decision not to renew the distribution relationship when the contract term expires?

The parties' freedom to contract generally governs the distribution relationship, including the parties' right to terminate or not to renew the relationship without cause or for specified reasons. However, some states' laws restrict the ability of franchisors, and of suppliers in certain industries, to end a relationship. Where a statutory restriction exists, it often prohibits termination without good cause, just cause or a similar formulation. This cause is often narrowly defined and typically does not include poor performance, but often does include a material failure to comply with reasonable contractual requirements, which makes clearly drafted and substantively reasonable contractual performance standards important. Moreover, many states require that, before termination occurs, the franchisee or distributor be given a specified period of time – often 60 or 90 days – in which to cure any deficiency or

breach. The statutory 'good cause' requirements typically, but not universally, apply equally to a failure to renew a contract on expiration.

In the absence of such a statute, however, there is generally no restriction on the parties' ability to agree on the conditions for termination with or without cause. Where there is no applicable statute and no agreement, or no contractual provision regarding termination, state law may imply requirements for reasonable notice or a reasonable time to recoup investments made by a distributor before permitting a termination without cause.

Law stated - 18 January 2024

10 Is any mandatory compensation or indemnity required to be paid in the event of a termination without cause or otherwise?

When an applicable statute restricts termination without good cause or where a termination violates a contract's terms, the wrongfully terminated distributor may recover damages and, in some cases, may be able to obtain injunctive relief preventing termination. (The requirements for injunctive relief vary from state to state, but typically require irreparable harm that is not adequately compensable with money damages. This is often interpreted to mean a likely inability for the business to survive in its current form.) Where damages are to be awarded, the amount will vary from state to state and usually is not defined by any specific formula or multiple of profits or sales. Often the damages will be defined as the fair market value of the distributor's business in the terminated product lines (ie, what a willing buyer and a willing seller, neither under compulsion to deal, would agree on for the price of the business). Damages may also be calculated as the net present value of the profits that would be earned by the distributor in the absence of termination. In the absence of an applicable statute or breach of contract, damages will not be assessed for a proper termination.

Law stated - 18 January 2024

Transfer of rights or ownership

11 Will your jurisdiction enforce a distribution contract provision prohibiting or restricting the transfer of the distribution rights to the supplier's products, all or part of the ownership of the distributor or agent, or the distributor or agent's business to a third party?

In general, yes. However, there may be specific federal and state laws applicable to certain industries (such as alcoholic beverages and motor vehicle fuel) that limit a supplier's ability to prevent transfers of ownership, or otherwise affect the enforceability of such provisions. For example, while the federal Petroleum Marketing Practices Act (PMPA), which restricts the ability of a supplier of motor vehicle fuel to terminate or fail to renew a retail dealer's franchise, but does not restrict supplier limitations on transfer of the franchise, many states have enacted laws that supplement the PMPA by regulating how a transfer of franchise rights may be restricted. For example, Maryland law prohibits unreasonably withholding consent to any transfer of a motor fuel marketing agreement.

Law stated - 18 January 2024

REGULATION OF THE DISTRIBUTION RELATIONSHIP

Confidentiality agreements

12 Are there limitations on the extent to which your jurisdiction will enforce confidentiality provisions in distribution agreements?

Confidentiality agreements are generally enforced as written, subject to normal contract defences, such as fraud or unconscionability, and subject to the obligation to disclose information in legal proceedings and government investigations. US courts have broad disclosure requirements, and the presence of a confidentiality provision will not shield information from discovery if it is material and necessary in the prosecution or defence of an action. While courts disfavour protective orders to maintain the confidentiality of information filed with the court, they can be obtained where necessary to protect competitively valuable information or in other cases where good cause can be shown, particularly where the parties to a litigation can agree. Confidentiality agreements between litigating parties are not unusual as a means of protecting sensitive information provided in discovery.

Information disclosed to government agencies may be subject to public disclosure under federal or state freedom of information laws, although there are exceptions, and protection of sensitive information should be discussed with the government prior to disclosure. Parties often want to include in confidentiality agreements a provision calling for advance notice and cooperation from the party being compelled to disclose, to the extent permitted, prior to making a disclosure required by law, so that the party whose sensitive information may be disclosed can seek appropriate protection. Parties should recognise, however, that the Securities and Exchange Commission has taken the position that agreements restricting disclosure or requiring notice to other parties either before or after disclosure are unlawful. It has required in settlement orders an affirmative disclaimer of any limitations on disclosures to government agencies of possible misconduct or in response to any government investigation. Other government agencies may similarly view advance notice as inappropriate, even if not actually prohibited, and the giving of such notice may prejudice a party's position vis-à-vis the agency. It thus may be prudent to exclude government requests for information and responses to such requests from the restriction on disclosure and the advance notice requirement.

Confidentiality agreements in the US typically exclude from protection information that the receiving party can demonstrate:

- was already known to the receiving party at the time of disclosure;
- became public without fault of the receiving party;
- was developed independently by the receiving party without reference to confidential information of the disclosing party; or
- was learned by the receiving party from a third party not owing any obligation of confidentiality to the disclosing party.

Where the information to be protected is not in fact confidential, as in these situations, a court may not enforce the agreement.

Trade secrets (ie, information that is not generally known and provides a competitive advantage to the owner) will be protected from disclosure or misappropriation where the owner has taken appropriate steps to maintain confidentiality, including obtaining written confidentiality agreements from all employees and others to whom the information is disclosed.

Law stated - 18 January 2024

Competing products

13 Are restrictions on the distribution of competing products in distribution agreements enforceable, either during the term of the relationship or afterwards?

In the absence of market power, a supplier generally is free to restrict a distributor's sales of competing products, although some state laws limit this ability. Where exclusive dealing requirements are so broad as to foreclose a substantial portion of the market, they may be found unlawful as an unreasonable restraint of trade under the antitrust (competition) laws. Restrictions that extend beyond the term of a distribution agreement are disfavoured in some states and generally must be ancillary to the contract and in furtherance of its lawful purposes, as well as reasonable as to the products restricted, the geographical scope of the restriction and the duration. Where a supplier provides a turnkey operation, as in a classic franchise, and discloses all the details of how to operate the business, such post-term restrictions may be more broadly permitted, particularly if they are short in duration and cover a limited geographical area.

Law stated - 18 January 2024

Prices

14 May a supplier control the prices at which its distribution partner resells its products? If not, how are these restrictions enforced?

In general, US antitrust laws, such as section 1 of the Sherman Act, in the absence of monopoly power, address concerted action, not unilateral conduct. Thus, if the supplier itself is making the sale, as is the case with owned outlets, a controlled subsidiary or, in most jurisdictions, through a true agent who arranges sales but never takes title to the product, the pricing is unilateral and usually not problematic. However, an agreement between independent entities in which the supplier regulates the resale prices of a distributor, franchisee or licensee raises antitrust concerns. Even in the case of a purported unilateral policy (eg, an announced supplier policy to deal only with retailers that maintain the manufacturer's suggested resale price), care must be taken to enforce the policy strictly. Lax enforcement together with ultimate compliance by the customer can be construed as evidence of a resale price maintenance (RPM) agreement rather than mere establishment of a unilateral policy.

In 2007, the US Supreme Court held, in *Leegin Creative Leather Products, Inc v PSKS, Inc-.*, that all vertical agreements (ie, agreements between the buyer and seller), even with respect to resale prices, are judged under federal law by the rule of reason, under which the court must determine whether the anticompetitive harm from the conduct is outweighed by the potential competitive benefits rather than by the per se rule, which makes conduct unlawful without regard to any claimed justifications. In*Leegin*, the Supreme Court noted a variety of situations in which such RPM may be anticompetitive, and suggested several factors relevant to the rule of reason inquiry, including the number of suppliers using RPM in the industry (the more manufacturers using RPM, the more likely it could facilitate a supplier or dealer cartel), the source of the restraint (if dealers are the impetus for a vertical price restraint, it is more likely to facilitate a dealer cartel or support a dominant, inefficient dealer) and where either the supplier or dealer involved has market power.

Importantly, the states do not always follow federal precedent in enforcing their own antitrust laws and so may not follow *Leegin*. Indeed, some states have antitrust statutes that explicitly bar RPM programmes. Thus, some state authorities will apply the per se rule to RPM under state law and deem it unlawful regardless of claimed procompetitive effects. The result is a patchwork of states accepting or rejecting the *Leegin* approach in enforcing state antitrust laws. Consequently, before implementing any RPM programme, counsel must carefully examine each relevant state's treatment of RPM, especially as state law continues to develop, review all the facts and determine whether any of the factors described by the Supreme Court in *Leegin* are present or whether there are other indications that the proposed programme will have anticompetitive effects rather than enhancing interbrand competition.

Law stated - 18 January 2024

15 May a supplier influence resale prices in other ways, such as suggesting resale prices, establishing a minimum advertised price policy, announcing it will not deal with customers who do not follow its pricing policy, or otherwise?

It is lawful in the US for a supplier to suggest resale prices so long as there is no enforcement mechanism and the customer remains truly free to set its own prices. In addition, under the rule announced in 1919 by the US Supreme Court in *United States v Colgate & Co*, a supplier may establish a unilateral policy against sales below the supplier's stated resale price levels and unilaterally choose not to do business with those that do not follow that policy, because only *agreements* on resale pricing may be unlawful, at least in the absence of market power. But care must be taken not to take steps that would convert such a unilateral policy into an agreement. When a supplier's actions go beyond mere announcement of a policy, and it employs other means to obtain adherence to its resale prices, an RPM agreement can be created. Colgate policies can be notoriously difficult to administer in practice because salespeople often try to persuade a customer to adhere to the policy instead of simply terminating sales upon a violation (with the resulting loss of sales to the salesperson), and such efforts can be enough to take the seller out of the Colgate safe harbour and into a potentially unlawful RPM situation.

Minimum advertised price (MAP) policies that control the prices a supplier advertises, but not the actual sales price, are also generally permitted, although the issue of what constitutes an advertised price for online sales can have almost metaphysical dimensions.

To avoid classification as RPM, the MAP policy must not control the actual resale price but only the advertised price. The closer to the point of sale that advertising is controlled, the greater the risk. Thus, in the bricks-and-mortar world, policies restricting advertising in broadcast and print media are more likely to be permitted; restrictions on in-store signage would be riskier, and restrictions on actual price tags on merchandise most likely would be deemed a restriction on actual, rather than advertised, price. Online, sellers have most often restricted banner ads and the price shown when an item is displayed. Restrictions on the price shown once a consumer places an item in his or her shopping cart carry a greater risk, which explains why some items are displayed with the legend 'Place item in cart for lower price'. Where the supplier does not prohibit an advertised price inconsistent with the supplier's policy, but instead, as part of a cooperative advertising programme, conditions reimbursement of all or a portion of the cost of an advertisement on compliance with a supplier's MAP policy, the risk is reduced, although not eliminated.

Law stated - 18 January 2024

16 May a distribution contract specify that the supplier's price to the distributor will be no higher than its lowest price to other customers?

In general, yes. Most favoured customer clauses are widespread, and courts generally have applied the rule of reason and found that they do not unreasonably restrain trade.

In 2010, however, the US Department of Justice filed an action in federal court in Michigan against health insurer Blue Cross Blue Shield (BCBS), claiming its use of these clauses thwarted competition, in violation of antitrust laws. The Department asserted that, because of its market power, BCBS harmed competition by requiring hospitals to agree to charge other insurers as much as 40 per cent more than they charged BCBS. (The case was voluntarily dismissed by the Department of Justice after the state of Michigan passed a law prohibiting health insurers from using most favoured customer clauses.) In the *Apple e-books* case, a federal district court found that a most favoured customer provision in Apple's contracts with publishers that required the publishers to lower the price at which they sold e-books in Apple's store if the books were sold for less elsewhere – notably by Amazon.com – violated the antitrust laws. The decision was affirmed on appeal by the US Court of Appeals for the Second Circuit. Apple sought Supreme Court review; however, the Court declined to review the decision.

The presence of most favoured customer clauses may also lead a supplier to reject an otherwise attractive offer from a customer to take surplus inventory at a lower price, because the discounted price would have to be offered to all customers with a most favoured customer clause. Other perceived potential anticompetitive consequences of most favoured customer clauses may include a tendency to foster price uniformity or to disfavour smaller businesses. Contract drafters should therefore examine whether a most favoured customer clause raises antitrust risks in the context of their client's particular market share and pricing practices, with particular caution advisable where market power is present.

Law stated - 18 January 2024

17 Are there restrictions on a seller's ability to charge different prices to different customers, based on location, type of customer, quantities purchased, or otherwise?

Yes. The federal Robinson–Patman Act prohibits, with certain exceptions, price differences (as well as discrimination in related services or facilities) in contemporaneous interstate sales of commodities of like grade and quality for use or resale within the US that causes antitrust injury. The basic principle is that big purchasers may not be favoured over small ones. The Robinson–Patman Act also requires promotional programmes to be available to customers on a proportionally equal basis. The Act does not apply to services, leases or export sales.

The statute is often criticised, and in the past was honoured more in the breach than the observance, as quantity discounts are commonplace and government enforcement actions were rare. Recently, however, President Biden's July 2021 Executive Order on Promoting Competition in the American Economy directed the FTC to rely more heavily on the RPA as a mechanism to police discriminatory supplier pricing practices, and federal authorities have indicating their intent to renew enforcement of the Act. Moreover, private damage actions, however, are still brought with some frequency, although the requirement of showing antitrust injury is often an obstacle to success. To prevail under the statute, a plaintiff must show that the price difference had a reasonable possibility of causing injury to competition or competitors in the same market or in the downstream market where favoured and disfavoured customers compete.

There are two principal defences to a Robinson–Patman Act claim. First, showing that the price difference was justified by cost differences is a defence. This defence, however, is notoriously difficult to establish, requiring detailed data as to the cost differences applicable to the different sales at different prices. Second, under the 'meeting competition' defence, prices may be lowered to meet (but not beat) a competitor's price, where there is a good faith basis for believing the competitor actually made a lower offer. If a copy of the competitor's invoice or price quotation cannot be obtained, the company should gather as much information as possible to support the belief that the competitor offered the lower price. The lower price must not, however, be confirmed with the competitor, which could provide evidence supporting a horizontal price-fixing conspiracy by the suppliers. Rather, the supplier should obtain that information through other sources, such as customer documentation or market surveys.

There are also state laws that restrict price discrimination. Some are generally applicable and modelled on the Robinson–Patman Act, but apply to intrastate sales instead of or in addition to interstate sales. Others restrict locality discrimination (ie, charging different prices in different parts of a state.) Some states, such as California, have unfair competition laws that prohibit below-cost pricing (which in certain circumstances may also violate federal law) and the provision of secret and unearned rebates to only some competing buyers. Other state laws apply to specific industries, such as motor vehicles or alcoholic beverages, and prohibit discrimination in pricing to dealers.

Law stated - 18 January 2024

Geographic and customer restrictions

18 | May a supplier restrict the geographic areas or categories of customers to which its distribution partner resells? Are exclusive territories permitted? Is there a distinction between active sales efforts and passive sales that are not actively solicited, and how are those terms defined?

As a general rule, yes. Non-price vertical restraints are judged by the rule of reason in the United States and are generally permitted, in the absence of market power. Customer and territory restrictions, such as exclusive territories, pursuant to which a distributor is allocated a specific territory outside of which it may not sell and within which no other distributor may sell the supplier's goods, thus are governed by the rule of reason. Exclusive territories necessarily reduce intrabrand competition between distributors of the same products. But by eliminating a competing distributor that could 'free-ride' on the promotional and service efforts of another and undercut its price, and thus making it feasible for the remaining distributor to sustain those efforts, exclusive territories can enhance interbrand competition between suppliers of competing products, and so are generally viewed as pro-competitive on balance.

The distinction between active and passive selling applicable in Europe is not generally relevant under US antitrust law. Another distinction from the European approach is that restrictions on online sales are viewed as a non-price vertical restraint and so are judged by the rule of reason and generally permitted, in the absence of market power. Courts have upheld prohibitions on mail order and telephone sales under the rule of reason, and restrictions on internet sales – even an absolute prohibition – should be judged no differently.

However, customer allocation by competitors is a horizontal arrangement rather than a vertical one and is per se illegal. It is thus critical that the impetus for exclusive territories come from the supplier in a vertical arrangement and not from dealers or distributors making a horizontal allocation of territories.

Many US cases apply a 'market power screen' in rule of reason cases, and uphold non-price vertical restraints whenever the defendant lacks market power. These restraints, including exclusive territories, will be viewed more sceptically if market power exists.

Law stated - 18 January 2024

19 | If geographic and customer restrictions are prohibited, how is this enforced?

Like most competition laws in the US, the geographic and customer restrictions, to the extent they may violate the law in some circumstances, may be enforced by federal or state antitrust authorities or challenged by a private party claiming to have suffered harm as a result. While horizontal antitrust violations may be the subject of criminal enforcement actions in some circumstances, it would be highly unusual for non-price vertical restraints to be the subject of criminal proceedings.

Law stated - 18 January 2024

Online sales

20 | May a supplier restrict or prohibit e-commerce sales by its distribution partners?

Restrictions on online sales are a non-price vertical restraint, judged by the rule of reason and generally permitted, in the absence of market power. Courts have upheld prohibitions on mail order and telephone sales under the rule of reason, and restrictions on internet sales – even an absolute prohibition – should be judged no differently.

Law stated - 18 January 2024

21 | May a distributor or agent restrict a supplier's sales through e-commerce intermediaries into the distribution partner's territory? May it require the supplier to obtain reports of such sales by territory and a payment of 'invasion fees' or similar amounts to the distribution partner?

The inherently borderless nature of e-commerce means that e-commerce sales, if permitted or secondarily sourced, may well adversely affect distributors into whose exclusive territories e-commerce sales are made, and may benefit distributors who have distribution centres of e-commerce intermediaries located in their territories from which sales are made to the territories of other distributors. These disproportionate effects may be dealt with in the contract by having the distributor that benefits from out-of-territory sales by an intermediary in its territory pay an 'invasion fee' or similar payment to the distributor into whose territory the sales are made, or by having the supplier make the payment to the infringed distributor. Of course, this requires a determination of the number of 'transferred' sales made by the intermediary. If reporting of those sales can be obtained, then the determination is easy. There is no legal prohibition on requiring such reports, but not all e-commerce intermediaries may be willing to provide them. In the absence of such reports, some kind of estimate is needed, perhaps based on relative non-e-commerce sales volumes in the territories. Again, the fundamental freedom to contract applies, and such determinations are permitted and becoming more common.

Law stated - 18 January 2024

Refusal to deal

22 | Under what circumstances may a supplier refuse to deal with particular customers? May a supplier restrict its distributor's ability to deal with particular customers?

In general, a business that does not have market power is free to choose its customers and do or not do business with whomever it wishes. This can include restricting a distributor's ability to do business with particular customers or classes of customers, a vertical restraint that will be judged by the rule of reason. A supplier with market power will be more limited in its ability to engage in such practices if an adverse effect on competition can be shown. In certain circumstances, courts have found that a monopolist may have an obligation to deal, or to continue dealing, with its competitors.

Note that an agreement among competitors at the same level of distribution not to deal with certain customers, or to restrict with whom customers may deal, will be treated as a

horizontal and per se illegal restraint rather than as a vertical restraint governed by the rule of reason. Thus, where a restriction on dealing with certain customers originates with a group of competing distributors, a supplier may be at risk of being found to be an illegal participant in that horizontal conspiracy, even though the same restraint might well be lawful if originated by the supplier.

There may be some industries in some states where a supplier is required to deal with all customers. For example, in many states, alcoholic beverage wholesalers must sell to all licensed retailers.

Law stated - 18 January 2024

Competition concerns

23 Under what circumstances might a distribution or agency agreement be deemed a reportable transaction under merger control rules and require clearance by the competition authority? What standards would be used to evaluate such a transaction?

Acquisitions of businesses or interests in businesses, including a supplier's purchase of an ownership interest in a distributor, may be subject to filing requirements and federal antitrust agency review if certain thresholds are met as to the size of the transaction (more than US$119.5 million) and the size of the parties. Regarding the latter, if the value of the proposed transaction is more than US$478 million, it is reportable; however, if the value is more than US$119.5 million but less than US$478 million, it is reportable if one party to the transaction has total assets or net sales of US$239 million or more and the other has total assets or net sales of US$23.9 million or more. These dollar amounts are adjusted annually for inflation. New dollar thresholds are expected to be announced in the first quarter of 2025. In the absence of an ownership interest, however, distribution relationships are not generally subject to antitrust reporting requirements or agency clearance procedures.

Law stated - 18 January 2024

24 Do your jurisdiction's antitrust or competition laws constrain the relationship between suppliers and their distribution partners in any other ways? How are any such laws enforced and by which agencies? Can private parties bring actions under antitrust or competition laws? What remedies are available?

Vertical agreements between suppliers and distributors are generally governed by the rule of reason, under which the anticompetitive effects of the restraint are weighed against any possible pro-competitive effects, and in the absence of market power, will usually be found lawful. In contrast, horizontal agreements among competitors at the same level of distribution relating to matters such as pricing, allocation of customers or territories, or production levels, are prohibited by the per se rule, without regard to purported procompetitive justifications.

Accordingly, it is important for suppliers and distributors not only to avoid such agreements with their competitors, but also to avoid putting themselves or their distribution partners into

a position where they might be deemed participants in a horizontal conspiracy at either distribution partner's level of distribution. Thus, suppliers should not exchange current or future pricing or production information with their competitors, should not use their common distributors to facilitate such information exchanges, should not share one distributor's pricing information with other distributors, and should not agree to territorial allocations made by their distributors rather than imposed by the supplier. Distributors should not share with one supplier pricing or production information received from another. Similarly, suppliers should not share information with each other about their common distributors as such exchanges could support a claim of a concerted refusal to deal should both suppliers then decide to terminate their relationships with the distributor.

Returning to purely vertical relationships, a supplier may not require its customers to purchase one product (the tied product) to be able to purchase another product (the tying product) if the supplier has substantial economic power in the tying product market, and a 'not insubstantial' amount of interstate or international commerce in the tied product is affected. One of the difficult questions in a tying analysis is whether there are in fact two distinct products, one of which is forced on customers who would not otherwise purchase it as a result of market power with respect to the other.

The antitrust laws are enforced both by government action and by private party litigation. At the federal level, both the US Department of Justice and the Federal Trade Commission (FTC) enforce the antitrust laws. They may seek criminal or civil enforcement penalties. Jail terms are not uncommon for horizontal antitrust violations. Maximum penalties for each violation are US$1 million and ten years in prison for individuals, and US$100 million for corporations, subject to being increased to twice the amount gained from the illegal acts or twice the money lost by the victims of the crime if either of those amounts is over US$100 million. In addition, both federal agencies can bring civil actions to enjoin violations of the antitrust laws, disgorge profits, impose structural remedies and recover substantial civil penalties. The federal agencies often cooperate with foreign antitrust and competition authorities in investigating violations.

State attorneys general also actively prosecute antitrust cases and have similar authority to the federal agencies within their own states. State antitrust laws also provide civil and criminal penalties, and the states frequently cooperate with each other and with the federal agencies in multistate investigations and prosecutions.

Last, but certainly not least, private plaintiffs may bring civil actions under the antitrust laws and recover treble damages – that is, three times the actual damages caused by the violation – and attorneys' fees (not the usual rule in the US, where each party generally pays its own legal fees, regardless of who prevails). The exposure in an antitrust action can thus be extremely high, as can the costs of litigation.

Law stated - 18 January 2024

Parallel imports

25 Are there ways in which a distributor or agent can prevent parallel or 'grey market' imports into its territory of the supplier's products?

Importation of goods bearing a registered trademark, even if genuine, can be blocked through the US Customs and Border Protection Service (CBP), provided the non-US manufacturer is not affiliated with the US trademark owner, under the Tariff Act, which prohibits the importation of a product manufactured abroad 'that bears a trademark owned by a citizen of . . . the United States'. The CBP can also block genuine trademarked goods not intended for the US market, even if the non-US manufacturer is affiliated, if the goods are physically and materially different from the goods intended for sale in the US. However, the grey importer can bring in the products if a disclaimer is affixed stating that the goods are materially and physically different from the authorised US goods. In addition, where parallel imported goods are materially different from the US goods in quality, features, warranty or the like, a trademark infringement claim is possible where customer confusion is likely.

There is no current ability to restrict grey market importation under a copyright theory. The Supreme Court held in 2013, in *Kirtsaeng v John Wiley & Sons Inc*, that a copyright owner cannot exercise control over a copyrighted work after its first sale, even if that first sale occurs outside the US. Moreover, reliance on an insubstantial element of a product protected by copyright to attempt to block parallel imports may be held to be copyright misuse, which prevents enforcement of the copyright.

At one time, grey market importation of products protected by a US patent infringed the patent even if the products were lawfully sold abroad with the authority of the patent holder. However, in 2017, the Supreme Court held in *Impression Prods, Inc v Lexmark Int'l, Inc* that an authorised sale abroad of a product protected by a US patent exhausted the patentee's right to prevent importation into the United States. Accordingly, patent law has been changed to conform to copyright law, as discussed above.

Law stated - 18 January 2024

Advertising

26 What restrictions exist on the ability of a supplier or distributor to advertise and market the products it sells? May a supplier pass all or part of its cost of advertising on to its distribution partners or require them to share in its cost of advertising?

Advertising is regulated by both federal and state laws that prohibit false, misleading or deceptive advertising. Where advertising makes statements that could reasonably be interpreted as an objective factual claim (in contrast to statements such as 'world's best water', that are more likely to be regarded as marketing puffery), the advertiser must have reasonable substantiating documentation to support the claim before the advertising is disseminated.

Federally, advertising is regulated principally by the FTC. The FTC has broad authority under the FTC Act to prevent 'unfair or deceptive acts or practices' and more specific authority to prohibit misleading claims for food, drugs, devices, services and cosmetics. The FTC can sue in the federal courts, and often will enter into consent orders with defendants in advance of litigation that may incorporate a variety of remedies.

The FTC considers advertising deceptive if it contains misrepresentations or omissions likely to mislead consumers acting reasonably to their detriment. While the FTC must show

the deception was material to consumers' purchasing decisions, it does not have to show actual injury to consumers. Similarly, the FTC deems advertising to be unfair if it causes or is likely to cause substantial consumer injury that is not reasonably avoidable by consumers themselves and is not outweighed by countervailing benefits to consumers or competition.

The most common remedy in advertising cases is an order to enjoin the conduct complained of and prevent future violations. Where such an order is not enough to correct misunderstandings caused by misleading advertising, the FTC may order corrective advertising. In addition, the FTC may seek other consumer redress or disgorgement of profits, and, in the case of violations of prior orders or trade regulation rules, civil penalties.

The states regulate advertising in similar ways under a variety of state unfair competition and unfair trade practice statutes. These are enforced by the state attorneys general in a manner similar to the FTC's enforcement of federal law.

Finally, private parties – often competitors – can bring actions in the state and federal courts to enjoin or seek damages for false or deceptive advertising that causes harm to competitors or consumers.

There are additional restrictions on specific types of advertising. Sweepstakes, in which prizes are awarded by chance to consumers who have made a purchase or provided some other consideration, are regulated by many states, some of which require prior registration. Endorsements are regulated, most notably by the FTC Endorsement Guides, which are intended to ensure that statements of third-party endorsers reflect an honest statement of the endorser's opinion and are substantiated to the same extent as required for the advertiser's own statements. These Guidelines require, among other things, disclosure of any relationship between the endorser and the supplier of the product, including requiring the supplier to ensure that those who review a product disclose when the supplier provided a free sample for evaluation and that employees who comment on their employer's products or services on social media or websites disclose that relationship. For example, when a social media personality or influencer endorses a particular brand, product or service, the influencer must make it clear that the influencer has a material connection – ie, a personal, family, employment, or financial relationship – with the endorsed products.

Finally, there are specific regulations governing certain claims, such as those asserting health benefits, or claiming 'green' products, and many industries have adopted self-regulatory advertising codes that also should be followed.

There are no restrictions on suppliers requiring reimbursement or contributions for advertising costs from distribution partners, or on distribution partners agreeing to share in advertising expenses. Freedom of contract governs, and it is commonplace to include provisions governing the sharing of advertising costs or the contribution from each party to advertising funds to support the products being distributed.

Law stated - 18 January 2024

Intellectual property

27 How may a supplier safeguard its intellectual property from infringement by its distribution partners and by third parties? Are technology transfer agreements common?

Trademarks

Trademarks receive some protection by virtue of use in the US under the federal Lanham Act and under the common law of the states where they are used. The preferable, more effective way to protect trademarks in the US is to obtain trademark registrations through the US Patent and Trademark Office. US trademark registrations can be based on a supplier's home country trademark registration or on use in interstate or foreign commerce in the US. Applications can also be based on an intent to use the trademark in the US, but the registration will not be issued until the supplier has submitted proof of actual use in the US. US federal trademark registration can also be obtained under the Madrid Protocol if the supplier's home country is a signatory to the treaty.

Only the owner of a trademark may obtain a US registration. Accordingly, in general the supplier, not the local distributor, will be the applicant. Contracts typically forbid the distributor from registering the trademark to protect the supplier from infringement by its distribution partner.

Patents

In general, patent protection in the US must be secured even if patent protection has been secured in the supplier's home country or other countries. To obtain a United States patent, the applicant must show that the invention is useful (ie the invention works and is not just theoretical), novel (ie not done before) and non-obvious over existing inventions. In addition, an invention cannot be patented in the US if it has been 'on sale' for more than a year prior to filing the patent application. What constitutes 'on sale' involves a complex body of law. Both actual sales and offers to sell constitute 'on sale'. Licensing may or may not constitute 'on sale' depending on the circumstances. Guidance from competent US patent counsel should be obtained. If a US patent application has not been filed within a specified period of time – usually one year – after the home country filing, a US patent will also not be available. A longer period may apply under the Patent Cooperation Treaty if the home country is a signatory.

Assuming there is US patent protection, the supplier may enforce the patent through private lawsuits in US courts against infringers. Both injunctive relief and damages are available remedies. Where the infringing goods are imported into the US, an exclusion order from the International Trade Commission may also be sought. While this procedure is faster, no damage remedy is available. Unauthorised sale of patented products by the distribution partner is usually regulated by contract but can also be remedied through an infringement suit.

Copyright

Under the US Copyright Act, the copyright in a work of authorship, including textual, artistic, musical and audiovisual works, is protected from the moment the work is fixed in a tangible medium of expression. Publication with a copyright notice is no longer necessary to retain US copyright protection. However, a supplier's ability to protect its copyrights

in the US is significantly enhanced by registration with the US Copyright Office. First, registration is required before a copyright can be enforced in the US courts. Second, where a copyright has been registered before an infringer's activities began, the remedies available for infringement are enhanced: the plaintiff need not prove actual damages from the infringement, but may elect to recover statutory damages in an amount, to be set by the court or jury, of up to US$150,000 per infringed work in the case of wilful infringement. In addition, where the copyright is registered, the plaintiff may recover, at the court's discretion, the costs of the suit, including attorneys' fees, which are not otherwise generally recoverable in the US.

Trade secrets and know-how

Trade secrets (ie, information that is not generally known and provides a competitive advantage to the owner) will be protected from disclosure or misappropriation where the owner has taken appropriate steps to maintain confidentiality, including obtaining written confidentiality agreements from all employees and others to whom the information is disclosed. Third parties who steal trade secrets (eg, by industrial espionage or hiring of key employees) may be sued for theft of trade secrets under applicable state or federal law. For employees, mere knowledge in a particular field acquired through long experience with one employer is not a protectable trade secret that will prevent a key employee from changing jobs. In such circumstances, non-compete agreements may give suppliers some protection, but there are limits on the time frame and geographical scope, and in recent years, several states have enacted laws restricting or prohibiting non-compete agreements for employees.

Technology transfer agreements

Technology transfer agreements are typically used to transfer technology from development organisations, such as universities or government, to commercial organisations for monetisation. They are not commonly used to structure the relationships between commercial suppliers and their distribution partners. In those cases, licence agreements are more common.

Law stated - 18 January 2024

Consumer protection

28 | What consumer protection laws are relevant to a supplier or distributor?

There are many federal and state consumer protection laws that are important to suppliers and distributors, well beyond what can be addressed in any detail here. At the federal level, these include a number of laws relating to consumer credit, including the Fair Credit Reporting Act, the Truth in Lending Act, the Fair Credit Billing Act, the Fair Debt Collection Practices Act, the Identity Theft and Assumption Deterrence Act of 1998 and the Credit

Accountability, Responsibility, and Disclosure Act. Other federal consumer protection laws and regulations include the CAN-SPAM Act (regulating the use of unsolicited commercial email), the FTC Used Car Rule, the FTC Mail or Telephone Order Merchandise Rule (which covers internet and fax sales as well as telephone and mail order sales and regulates shipment times and related statements and cancellation rights), the FTC Telemarketing Sales Rule under the Telemarketing and Consumer Fraud and Abuse Prevention Act, and various labelling and packaging requirements for food and beverages, textiles and wool, appliances, alcoholic beverages and other industries. To gain a sense of the range of regulations and to review FTC guidance on the subject, visit the FTC website.

In addition, most states have very broad consumer protection laws governing unfair or deceptive trade practices and specific laws governing industries such as mobile homes, health clubs, household storage, gasoline stations and others. Often these provide a consumer right, within a defined period, to rescind contracts made in certain circumstances. For example, in New York, there is a 72-hour right to cancel for door-to-door sales, dating services, health clubs and home improvement contracts. Contracts for such transactions must clearly state the right to cancel.

Law stated - 18 January 2024

Product recalls

29 Briefly describe any legal requirements regarding recalls of distributed products. May the distribution agreement delineate which party is responsible for carrying out and bearing the cost of a recall?

Recalls of products are regulated by a number of federal and state agencies, including the Food and Drug Administration, the US Department of Agriculture and the Consumer Product Safety Commission. In addition, manufacturers, importers and distributors often initiate voluntary recalls to remove a defective or dangerous product from the marketplace before it can cause harm, to avoid the potential liability and reputational harm that can come from damage, injuries or deaths.

It is prudent to define in the distribution contract the parties' respective responsibilities in the event of a recall, including who may decide to initiate a recall, how it will be implemented and who will pay the costs, including credits that direct and indirect customers may require for recalled products.

Law stated - 18 January 2024

Warranties

30 To what extent may a supplier limit the warranties it provides to its distribution partners and to what extent can both limit the warranties provided to their downstream customers?

There are both federal and state laws regulating warranties. The main federal law is the Magnuson–Moss Warranty Act, which applies to consumer products with a written

warranty. While there is no requirement that a warranty be offered, if a written warranty is provided, then the Act requires certain disclosure of warranty terms, imposes certain requirements, and mandates certain remedies for consumers.

The Act and the FTC Rules promulgated under it require that a written warranty be stated to be either 'full' or 'limited' for any consumer product that costs more than US$10, and imposes disclosure requirements for products costing more than US$15. Specified information about the coverage of the warranty must be set forth in a single document in simple, readily understood language, and the warranties must be available where the products are sold so that consumers can read them before deciding to purchase.

A warranty is 'full' only if:

- it does not limit the duration of implied warranties;
- warranty service is provided to anyone who owns the product during the warranty period, not just the first purchaser;
- warranty service is provided free, including costs of returning, removing and reinstalling the product;
- the consumer may choose either a replacement or a full refund if the product cannot be repaired after a reasonable number of attempts; and
- consumers are not required to do anything as a condition to obtain warranty service (including returning a warranty card), other than to give notice that the product needs service, unless the requirement is reasonable.

If any of the above conditions is not met, then the warranty is 'limited' rather than 'full'.

The FTC requires disclosure of certain elements in every warranty, including precisely what is and is not covered by the warranty, when the warranty begins and ends, how covered problems will be resolved and, if necessary for clarity, what will not be done or covered (eg, shipping, removal or reinstallation costs, consequential damage caused by a defect, incidental costs incurred), and a statement that the warranty 'gives you specific legal rights, and you may also have other rights which vary from state to state'. Any additional requirements or restrictions, such as acts that will void the warranty, must be disclosed.

The Magnuson–Moss Act prohibits a written warranty from disclaiming or modifying any warranties that are implied under applicable law, although a limited warranty may limit the duration of implied warranties to the duration of the limited warranty, subject to contrary state law.

A written warranty cannot be conditioned on the consumer product being used only with specific other products or services, such as particular accessories, but it may provide that it is voided by the use of inappropriate replacement parts or improper repairs or maintenance. A waiver can be obtained from the FTC if it can be shown that a product will not work properly unless specified parts, accessories or service are used.

The FTC, the US Department of Justice and consumers can sue to enforce the Act, and consumers can recover their court costs and reasonable attorneys' fees if successful. The Act also encourages businesses to establish informal dispute resolution procedures to settle warranty disputes. Such procedures must meet certain requirements and must not be binding on the consumer.

In addition, other federal laws and regulations govern topics such as warranties for consumer leases, used cars and emissions control systems, as well as advertising of warranties.

In almost all states, warranties are governed by the Uniform Commercial Code, which provides for an express warranty, an implied warranty of merchantability and an implied warranty of fitness for a particular purpose. The implied warranty of merchantability is an implied promise, whenever the product is sold by a merchant, that the goods will function properly for the ordinary purposes for which they are used, would pass without objection in the trade, are adequately packaged and labelled, and conform to any promises made in labelling or packaging. The implied warranty of fitness for a particular use exists only when the seller has reason to know the purpose for which the buyer intends to use the product at the time it is sold, and the buyer relies on the greater knowledge and recommendation of the seller in selecting the product.

The extent to which implied warranties may be disclaimed varies by state. Where permitted, disclaimers usually must be conspicuous, usually interpreted as boldface capital letters. Similarly, state law may permit sellers to limit the damages and other remedies available in case of a breach of warranty. Notice of such disclaimers also generally must be conspicuous.

Many states also have specific 'lemon laws' governing motor vehicles.

Law stated - 18 January 2024

Data transfers

31 Are there restrictions on the exchange of information between a supplier and its distribution partners about the customers and end users of their products? Who owns such information and what data protection or privacy regulations are applicable?

In contrast to many other countries, federal privacy regulation in the United States is limited to a few specific areas, such as children's information, healthcare, financial services and telecommunications. The primary federal regulatory focus is on matters such as transparency to the consumer with respect to the manner in which information will be used and shared and the reasonableness of the data security protections in place. The FTC and other federal agencies have adopted rules in these areas, generally requiring notice to consumers about the collection and use of information; consumer choice with respect to the use and dissemination of information collected from or about them; consumer access to information about them; and appropriate steps to maintain the security and integrity of any information collected. The FTC and state regulatory authorities have also been active in regulating behavioural advertising, mobile apps and information security, and businesses gathering customer information should familiarise themselves with the FTC's guidance in these areas.

Sharing of personal information between US distribution partners and their suppliers located in the EU, the UK and other countries that have strict data protection requirements continues to be a difficult area to navigate. In addition, the EU's General Data Protection

Regulation (GDPR), which has been in effect since May 2018, applies to parties in the United States that offer goods or services (even for free) to individuals in the European Economic Area and process personal data of individuals in the European Economic Area in connection with that activity. The GDPR's definition of 'personal data' is very expansive, and provides that a wide range of personal identifiers (eg, IP addresses) constitutes personal data. The GDPR gives individuals in the EU greater control over their personal data and imposes many obligations on organisations that collect, handle and otherwise process personal data. It also gives national data protection authorities the power to impose significant fines on organisations that fail to comply.

The *Schrems I and II* decisions have invalidated prior arrangements such as the Safe Harbour principles agreed to between the FTC and the EU (in effect until 2015), and the EU-US Privacy Shield (in effect from 2016 to July 2020). After *Schrems II,* work began on a replacement regime that would meet the requirements of EU privacy protection, resulting in the EU-US Data Privacy Framework (EU-US DPF). The EU has determined that the additional safeguards included in the EU-US DPF and an Executive Order issued by US President Biden provide an adequate level of protection for personal data transferred from the European Union. The adequacy decision allows the EU–US DPF to facilitate the transfer of data from Europe to the United States. To participate in the EU–US DPF, companies must self-certify and publicly commit to comply with the EU–US DPF Principles, which are enforceable under US law. They can also self-certify their compliance with the UK Extension to the EU–US DPF and will be able to certify compliance with the Swiss–US DPF Principles after Switzerland completes its legal process to deem data transfers to and from Switzerland to have adequate protection. As an alternative to the EU–US DPF, parties to EU–US distribution relationships may rely on binding corporate rules (which are expressly permitted under GDPR) or on standard contractual clauses that have been approved by the European Commission (which remain a permitted mechanism to transfer personal data outside the European Union, at least for now). Typically, a lengthy, detailed Data Processing Addendum, which details each party's responsibilities, requires compliance with the GDPR and/or other relevant countries' data processing requirements and adopts the standard contractual clauses, is included in the distributorship agreement or other supplier-distributor agreement. The agreement should, either in the body or the Data Processing Addendum, clearly define who controls the customer information that has been collected (ie, who has the right to determine the purposes and means of processing that information), who has access to it, and the applicable confidentiality obligations (which must conform to the parties' respective stated privacy policies, which in turn must be consistent with each other). In the absence of such a definition, customer data is likely to belong to the party that collected it, but the sharing of such information without a statement of the recipient's obligations may result in the recipient's ability to do as it wishes with the information. Suppliers and their distribution partners should also cooperate in planning to prevent security breaches and to respond to them in accordance with applicable law when they occur.

It remains entirely possible that Mr. Schrems or others may launch further challenges to the transfer of personal information between other countries and the US that could affect the above alternatives.

In addition to federal law, all US states and most US territories have also adopted legislation governing consumer information, with data breach legislation imposing notification obligations and remedial action in the event of a security breach being the most

common. These state requirements sometimes conflict, which can create compliance problems. Increasingly, states are imposing broader data privacy requirements legislation on businesses that collect consumer information. The first such statute, the California Consumer Privacy Act of 2018 is a comprehensive data privacy law that affects businesses around the world that obtain, use, store or otherwise process the personal information of California residents (including California residents who are temporarily located in other places). Among other things, this law provides California residents the right to know what personal information is being collected about them, the right to know whether their personal information is sold or disclosed and to whom, and the right to say no to the sale of personal information. Other states have followed California's lead with their own legislation, which, for the most part, is not as stringent as the California Act but often incorporates elements of it, and the list of states enacting such laws is constantly growing.

In addition, the GDPR, which took effect in May 2018, applies to parties in the United States that offer goods or services.

Law stated - 18 January 2024

32 What requirements apply to suppliers and their distribution partners with respect to protecting the security of customer data they hold?

Many US states require businesses that own, license or maintain personal information about the residents of their states to implement and maintain 'reasonable security procedures and practices', and to protect personal information from unauthorised access, destruction, use, modification or disclosure. However, many of those laws and regulations do not specify what exactly constitutes reasonable security procedures.

Other states are more specific in their requirements. For example, the states of New York and Massachusetts both require businesses that own or license the personal information of the state's residents to develop, implement and maintain comprehensive written information security programs that contain specific administrative, technical and physical safeguards for the protection of personal information. Under New York State's Stop Hacks and Improve Electronic Data Security (SHIELD) Act, businesses that own or license computerised data that includes private information of the state's residents must implement a data security programme that includes the following elements:

- administrative safeguards in which the business:
    - designates one or more employees to coordinate the security programme;
    - identifies reasonably foreseeable internal and external risks;
    - assesses the sufficiency of the safeguards in place to control the identified risks;
    - trains and manages employees in the security programme practices and procedures;
    - selects service providers capable of maintaining appropriate safeguards and requires those safeguards by contract; and
    - adjusts the security programme in light of business changes or new circumstances;

- technical safeguards in which the business:
    - assesses risks in network and software design;
    - assesses risks in information processing, transmission and storage;
    - detects, prevents and responds to attacks or system failures; and
    - regularly tests and monitors the effectiveness of key controls, systems and procedures; and
- physical safeguards in which the business:
- assesses risks of information storage and disposal;
- detects, prevents and responds to intrusions;
- protects against unauthorised access to or use of private information during or after the collection, transportation and disposal of the information; and
- disposes of private information within a reasonable amount of time after it is no longer needed for business purposes by erasing electronic media so that the information cannot be read or reconstructed.

In addition to statutory and regulatory requirements, parties may contractually agree with each other to maintain security measures that are specified in that contract. If one party fails to abide by its commitments in the contract, it may be liable to the other party for breach of contract.

Law stated - 18 January 2024

Employment issues

33 May a supplier approve or reject the individuals who manage the distribution partner's business, or terminate the relationship if not satisfied with the management?

Under the general principle of freedom of contract, the parties generally may provide as they wish with respect to supplier control over the persons who manage the distributor. Thus, the contract can grant authority to a supplier to approve or reject the individuals who manage the distribution partner's business generally, or the distribution of the supplier's products specifically, for any lawful reason, as well as to terminate the agreement if not satisfied. This general principle is subject to specific franchise or industry regulation. Particularly for alcoholic beverages, many states have laws designed to protect the independence of wholesale distributors; in such states, provisions giving suppliers control over distributor management may be problematic and unenforceable. Where termination is limited to statutorily defined good cause, a right to terminate for dissatisfaction with management may be unenforceable.

Law stated - 18 January 2024

34 Are there circumstances under which a distributor or agent, or its employees, would be treated as an employee of the supplier, and what are the consequences of such treatment? How can a supplier protect against responsibility for potential violations of labour and employment laws by its distribution partners?

There is a risk that distributors – especially those that are single-employee companies or sole proprietorships – may be deemed employees of the supplier. To prevent this, it is in the supplier's interest to ensure an independent contractor relationship between itself and the distributor.

Some states, such as California, have passed or are in the process of adopting legislation establishing a presumption that individuals performing services are employees and outlining baseline factors that must be satisfied for an individual to be considered an independent contractor.

Under federal regulations, the determination of whether there is an employee or independent contractor relationship is based on whether the totality-of-the-circumstances demonstrates economic dependence. The US Department of Labor maintains that 'economic dependence' is the ultimate inquiry, and that an employee is someone who, as a matter of economic reality, is economically dependent on an employer for work, as opposed to being in business for themself.

The Department has identified six economic reality factors to be considered: (1) opportunity for profit or loss depending on managerial skill, (2) investments by the worker and the potential employer, (3) the degree of permanence of the relationship, (4) the nature and degree of control exercised, (5) the extent to which the work performed is an integral part of the potential employer's business and operations, and (6) skill and initiative. The factors do not each have a predetermined weight and are considered in view of the economic reality of the situation as a whole. Additional factors may also be considered if they are relevant to the overall question of economic dependence.

While tests for distinguishing bona fide independent contractors from employees vary among states, agencies, and statutes, in the context of a supplier-distributor relationship relevant questions include.

- Does the distributor perform similar work for other clients and market similar services to the general public, or does it work exclusively for the supplier?
- Has the distributor made substantial investments in its own vehicles or other equipment or does the distributor rely on equipment of the supplier?
- Does the distributor hire its own employees to perform services for the supplier?
- Does the distributor control its schedule and how it accomplishes its work or is it subject to the supplier's direction?
- Is the parties' relationship limited in duration or open-ended?
- Does the distributor have substantial skills, experience and training, or is supplier training required?
- Are the distributor's services similar to those of direct employees of the supplier?
-

Does the distributor earn a profit or risk a loss on resales or receive a sales commission or other compensation for its results, or is it compensated for its time (eg, on an hourly or salary basis)?

- Does the distributor receive employee-type benefits from the supplier (eg, paid time off and health insurance)?

Although no single factor is dispositive; the written distribution agreement should clearly state the parties' intent and highlight those factors that support the classification agreed upon and intended by the parties.

Misclassification may result in substantial employment and tax liabilities for the supplier, including retroactive pay and benefits, other damages and substantial fines and penalties. Employees are generally entitled, among other benefits, to minimum wage and overtime compensation, discrimination and workplace safety protections, unemployment benefits, workers' compensation and disability insurance, protected family, medical and military leaves of absence, and a right to participate in the employer's retirement and health plans and other benefits. While federal law provides certain employee rights, other mandated benefits, such as paid sick leave, vary from state to state.

There is also a risk that a supplier could be deemed a joint employer of an individual employed by a distributor, rendering the supplier liable for compliance with statutory obligations to the employee, such as minimum wage or overtime, paid sick leave, other employee benefits and protection against harassment. Factors looked at to determine whether a supplier is the joint employer of a distributor's employee include (i) whether the supplier regularly controls the employee's schedule or workload, benefits from the individual's services, supervises the employee, or has any overlapping owners, officers or managers with the distributor, and (ii) whether the employee is economically dependent on both the supplier and the distributor (eg, whether the supplier has the power to hire, fire or discipline the employee, or to change any of the employee's terms of employment), and how long the distributor's employee has performed the services for the benefit of the supplier.

According to a broad definition of joint employers recently adopted by the National Labor Relations Board, an entity may be considered a joint employer of another employer's employees if the two share or codetermine the employees' essential terms and conditions of employment. This definition will have limited direct impact on non-unionized workforces.

Suppliers should engage experienced employment counsel to analyse the relevant facts and determine the proper classification of individuals as either employees or independent contractors, as well as to advise on best practices to avoid a joint employer relationship being established with the distributor's employees.

Law stated - 18 January 2024

Commission payments

35 | Is the payment of commission to a commercial agent regulated?

About half the US states have laws regulating commission sales representatives. These laws typically require written agreements setting forth how commission is calculated and require payment within a specified period after termination. Some laws provide for double or treble damages for violations. A few, such as Puerto Rico and Minnesota, restrict a supplier's right to terminate a sales representative without statutory good or just cause. In some states, sales representatives may also be protected by franchise laws in certain circumstances.

Law stated - 18 January 2024

Good faith and fair dealing

36 | What good faith and fair dealing requirements apply to distribution relationships?

A covenant of good faith and fair dealing is implied by the laws of most states in all commercial contracts, including distribution agreements. This requires the parties to deal with each other in good faith, but generally does not supersede express contractual provisions. Thus, a complaint that a supplier terminated a distribution contract in bad faith, in violation of the covenant of good faith and fair dealing, will generally not succeed in the face of a contractual provision allowing the supplier to terminate without cause. Indeed, cases in a number of states hold that a claim cannot be based solely on a breach of the implied covenant of good faith without some breach of an express provision as well.

In contrast, other courts have found a violation of the implied covenant of good faith where suppliers have acted to the disadvantage of their dealers, notwithstanding an express provision permitting the conduct at issue. For example, a federal district court found that sales by the Carvel ice cream company to supermarkets might violate its duty of good faith to its franchisees, notwithstanding its contractually reserved right, in its 'sole and absolute discretion', to sell in the franchisees' territory via the same or different distribution channels.

Similarly, some courts have found a violation of the implied covenant of good faith where the manner in which a supplier exercised its contractual rights demonstrated bad faith, such as disparagement of the distributor or misappropriation of confidential customer information in connection with an otherwise permitted termination.

Moreover, some specific industry laws impose an explicit obligation of good faith on suppliers and distributors that may be independently enforceable.

Law stated - 18 January 2024

Registration of agreements

37 | Are there laws requiring that distribution agreements or intellectual property licence agreements be registered with or approved by any government agency?

With the exception of those state franchise laws that require registration of disclosure documents and some state laws governing specific industries, such as alcoholic beverages, there generally are no such requirements.

Law stated - 18 January 2024

Anti-corruption rules

38 To what extent are anti-bribery or anti-corruption laws applicable to relationships between suppliers and their distribution partners?

It is important that counsel for multinational businesses recognise the risks to a supplier of third-party misconduct by foreign distributors and agents under the Foreign Corrupt Practices Act (FCPA). The FCPA, a criminal statute, prohibits bribery of foreign officials, political parties and candidates for public office. Under the FCPA, a company or individual can be held directly responsible for bribes paid by a third party if the company or individual has knowledge of the third party's misconduct. For example, the FCPA prohibits the giving of anything of value to 'any person' while knowing that all or a portion of the money or thing will be given, 'directly or indirectly', to bribe any foreign official, foreign political party or official, or any candidate for foreign political office. Moreover, constructive knowledge of the misconduct, including wilful blindness or deliberate ignorance, is enough to impose liability. A defendant may be convicted under the FCPA based upon the defendant's 'conscious avoidance' of learning about a third party's illegal business practices. Accordingly, it is critically important to take steps to prevent such misconduct by those acting on a business's behalf, including distributors, agents, brokers, sales representatives, consultants, advisers and other local business partners. A business with foreign business partners must exercise appropriate due diligence in selecting its partners and adequately supervise their activities. It is important to consider FCPA compliance (1) before entering into an agreement with a foreign partner through due diligence, (2) in the agreement through provisions requiring FCPA compliance and reporting, and (3) after entering into the agreement through ongoing training, monitoring and audits.

Law stated - 18 January 2024

Prohibited and mandatory contractual provisions

39 Are there any other restrictions on provisions in distribution contracts or limitations on their enforceability? Are there any mandatory provisions? Are there any provisions that local law will deem included even if absent?

Except for specific industry regulation, franchises and antitrust restrictions, the parties are generally free to structure their relationship as they wish. Of course, distribution contracts are subject to the usual contract enforceability defences, such as fraud, unconscionability and lack of consideration, among others. There are certain warranties and a covenant of good faith and fair dealing that are implied by law. Laws governing specific industries and franchises may impute or require other provisions.

In addition, if the contract gives a supplier effective control over the distributor's operations, it may be held vicariously liable to third parties for the distributor's negligence or other misconduct. Similarly, a supplier may be liable for conduct of a distributor if the conduct is

required by the supplier or the distributor is represented to third parties as being part of the supplier's operations.

Law stated - 18 January 2024

GOVERNING LAW AND CHOICE OF FORUM

Choice of law

40 Are there restrictions on the parties' contractual choice of a country's law to govern a distribution contract?

A choice of law provision in the distribution contract selecting the law of a specific state or country may be enforced if the jurisdiction chosen bears a reasonable relationship to the transaction (eg, the supplier's or distributor's home jurisdiction). Such contractual choice of law provisions, though generally enforced, are sometimes disregarded by courts in deference to the public policy of states with business franchise or protective industry laws, or because the validity of the contract containing the clause was questioned. Courts have also refused to enforce choice of law provisions that bear no reasonable relation to the parties or contract.

Selecting a particular state's law may result in the application of either a more or less restrictive state franchise law than might otherwise be the case.

Combining a choice of favourable law with an arbitration clause will enhance the likelihood of the choice of law being enforced. The strong federal policy in favour of arbitration, embodied in the Federal Arbitration Act, generally has been held to support the parties' choice of law to be applied in arbitrations, even in the face of explicit state law to the contrary.

Unless the parties explicitly disclaim its applicability, the United Nations Convention on Contracts for the International Sales of Goods will govern contracts for sales of goods between parties that have their places of business in different contracting states, of which the US is one.

Law stated - 18 January 2024

Choice of forum

41 Are there restrictions on the parties' contractual choice of courts or arbitration tribunals, whether within or outside your jurisdiction, to resolve contractual disputes?

The parties can provide in the distribution contract for all litigation to be brought in a court located in a particular state or country and can waive their right to seek a transfer. These clauses are sometimes enforced and sometimes not. The Supreme Court, in *Burger King Corp v Rudzewicz*, has held that a franchisor can constitutionally enforce a forum-selection clause against its franchisees in an action commenced by the franchisor in its home state. Courts in the distributor's home state, however, may refuse to enforce a forum-selection clause on the ground that the public policy interests of the distributor's state outweigh the

parties' choice. State franchise laws may expressly prohibit the choice of another state as a forum. Federal courts, however, will apply federal law to determine whether to enforce such a clause, notwithstanding any such state view. The forum clause is not dispositive, but should be considered together with the other factors normally weighed in a transfer motion, at least where the choice is between two federal districts.

A showing of state policy sufficient to outweigh a forum clause may be difficult to make. For example, Maryland courts have held that a forum selection clause favouring the franchisor's home state was enforceable despite being incorporated into a form contract where the franchisor had superior bargaining power, reasoning that there was no fraud involved, and a federal district court in New York upheld a one-sided forum clause that restricted venue in actions by a franchisee, but not in actions by the franchisor. In contrast, the District of Puerto Rico declined to transfer a dispute to California courts as required by a contractual forum clause, as Puerto Rico was more convenient for witnesses, and there was no evidence justifying transfer other than the contract clause.

Arbitration clauses specifying a particular forum are likely to be enforced under the Federal Arbitration Act. The Seventh Circuit US Court of Appeals reversed a district court decision and ordered arbitration in Poland pursuant to contract in a case under the Illinois Beer Industry Fair Dealing Act, holding that the state's public policy expressed in that statute required Illinois law to apply notwithstanding the contract's choice of Polish law, but that this public policy could not overcome the Federal Arbitration Act policy in favour of arbitration.

Law stated - 18 January 2024

Litigation

42 What courts, procedures and remedies are available to suppliers and distribution partners to resolve disputes? Are foreign businesses restricted in their ability to make use of these courts and procedures? Can they expect fair treatment? To what extent can a litigant require disclosure of documents or testimony from an adverse party? What are the advantages and disadvantages to a foreign business of resolving disputes in your country's courts?

Suppliers and their distribution partners have access to both state and federal courts to resolve their disputes, although a company that fails to file its qualification to do business in a state in which it meets the definition of 'doing business' usually will not be entitled to maintain any action or proceeding in the courts of the state. This rule applies to both US companies formed in other states and non-US companies, and in general foreign businesses have equal access to the courts. By and large, foreign companies can expect fair treatment in US courts, especially in the federal courts and courts of the larger commercial states. Some states, such as New York, have a well-established body of commercial law and have created specialised commercial courts with judges experienced in commercial disputes, making these courts a desirable forum for dispute resolution.

Discovery in US courts is very broad, typically requiring disclosure of documents and electronic materials, responses to written interrogatories and deposition testimony of witnesses whenever material and necessary in the prosecution or defence of an action. This substantially increases the cost of litigation in US courts. In response, subject to showing a need for greater discovery, some courts have enacted rules that place limits on

the length of depositions, the number of witnesses that may be deposed and the number of interrogatories that may be propounded. Electronic discovery of documents and email is also generally quite broad and can be a significant cost, although some courts may shift that cost to the party seeking the discovery in certain circumstances. In addition, federal and state courts have implemented rules to permit parties to seek to limit discovery so that it is proportionate to the value of the material sought and the value of the case.

Certain industry regulations and industry self-regulatory codes may provide or require certain disputes, such as a claim of wrongful termination, to be resolved before government agencies or industry boards.

Law stated - 18 January 2024

Alternative dispute resolution

43 Will an agreement to mediate or arbitrate disputes be enforced in your jurisdiction? Are there any limitations on the terms of an agreement to arbitrate? What are the advantages and disadvantages for a foreign business of resolving disputes by arbitration in a dispute with a business partner in your country?

A provision for binding arbitration of disputes in place of the courts will generally be enforced under the Federal Arbitration Act (FAA), which favours arbitration agreements, even in the face of state law to the contrary. However, where state law requires – as some state business franchise laws do – a disclosure that a choice of law or choice of forum provision, including an arbitration clause, may not be enforceable in that state, a question arises as to whether the parties really agreed to the provision. The Ninth Circuit US Court of Appeals has held that a contractual choice of forum for arbitration was unenforceable because of such a mandated disclaimer, finding that the franchisee had no reasonable expectation that it had agreed to arbitrate out-of-state.

Provisions limiting the relief arbitrators may award to actual compensatory damages, or expressly precluding punitive damages, injunctive relief or specific performance, will also generally be enforceable. The US Supreme Court has held that the FAA's central purpose is to ensure 'that private agreements to arbitrate are enforced according to their terms', so that the parties' decision as to whether arbitrators may award punitive damages will supersede contrary state law. Similarly, courts generally will also enforce a provision for a particular arbitration forum.

However, care should be taken in drafting arbitration clauses not to overreach, because even under the FAA, arbitration agreements may be set aside on the same grounds as any other contract, such as fraud or unconscionability. For example, the Ninth Circuit held an arbitration clause unconscionable, and so unenforceable, where franchisees were required to arbitrate but the franchisor could proceed in court. A district court in California rejected an arbitration clause as unconscionable where the arbitration clause blocked class adjudication (requiring each case to be resolved individually) and proved unfavourable for plaintiffs on a cost-benefit analysis. It is thus prudent to adopt a more balanced approach in drafting arbitration provisions.

Arbitration is private, in contrast to the courts, and, depending on the court, can sometimes be faster and cheaper. It may afford less discovery and can present problems requiring

testimony of non-parties, to the disadvantage of a party who needs them. There is generally no appeal from a legally incorrect or factually unfounded decision and arbitrators often seek a compromise result.

While there is no similar statutory underpinning for provisions requiring non-binding mediation before parties may proceed to court or binding arbitration, such a provision generally will be enforced under principles of freedom of contract.

Law stated - 18 January 2024

UPDATE AND TRENDS

Key developments

44 Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? Are there any other current developments or trends that should be noted?

A clear legislative trend in the US is the adoption by states of laws governing data privacy and security. All 50 states have now adopted breach notification laws. Increasingly, states are adopting broader consumer privacy laws, such as the California Consumer Privacy Act, the Nevada Privacy of Information Collected on the Internet from Consumers Act and Maine's Act to Protect the Privacy of Online Customer Information. Similar legislation is in force in Virginia and Connecticut, and new consumer privacy protection acts came into force in 2023 in Colorado and Utah. Several other states have passed consumer privacy protection acts that will become effective in the future. These include Iowa (effective 1 January 2025), Indiana (effective 1 January 2026), Tennessee (effective 1 July 2025), Montana (effective 1 October 2024), Florida (effective 1 July 2024), Texas (effective 1 July 2024), Oregon (effective 1 July 2024) and, most recently, Delaware (effective 1 January 2025). The provisions governing applicability and scope of each state's law differ. Whether a given state's law applies to a particular supplier-distributor relationship needs to be individually evaluated.

Security of consumer data is also becoming regulated by state laws, such as the New York Stop Hacks and Improve Electronic Data Security Act (SHIELD Act) and Massachusetts's amendments to its data breach law addressing data security programmes.

The increasing number of different state data privacy laws has resulted in a patchwork of differing and sometimes inconsistent state laws regulating data privacy, breach and security programmes, creating a compliance morass for businesses doing business nationally. There is a clear need for uniform federal legislation in these areas and industry is increasingly supporting federal legislation beyond the existing legislation governing healthcare, financial services, telecommunications and data gathered from children. Although efforts to develop such federal legislation are ongoing, enactment of any such legislation in the near future is unlikely. Thus, states can be expected to continue to legislate individually, and the compliance challenges of dealing with the maze of state laws will continue to grow in the near term.

The authors would like to gratefully acknowledge the invaluable contribution of Charles R Goodwin to this chapter.

Law stated - 18 January 2024

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