MANAGING DISTRIBUTION ARRANGEMENTS AT HOME AND ABROAD:
A MULTIDISCIPLINARY PERSPECTIVE

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SECTION II:

TRANSACTIONAL AND REGULATORY CONSIDERATIONS IN A GLOBAL ECONOMY

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I. INTRODUCTION:

A. Opportunities and Risks Abound: U.S. companies of all sizes have experienced tremendous opportunities in foreign markets in recent years due to many factors, including lowering of trade barriers, technological advances, and federal and state export promotion programs. In addition, outsourcing involving proprietary goods and technologies has become increasingly common as a strategy to remain competitive locally. Moreover, recent years have seen many closely-held and relatively small companies enter the global market directly, in spite of the challenges of inexperience and limited resources. Effective implementation of business strategies in light of these dynamic market factors requires not only a proactive and well-informed approach initially, but also ongoing monitoring and refinement.

The challenge of implementing an effective global distribution strategy is compounded by U.S. export and import regulatory requirements and the myriad of foreign laws, trade agreements and treaties which are in some cases unfortunately complex and at times ill-suited to deal with new business modalities. The regulatory compliance hurdle is exacerbated by the speed and ease with which regulatory agencies can now access information due to electronic filing and reporting requirements and heightened U.S. government scrutiny since the tragic events of September 11. As a result, more potential pitfalls and traps for the unwary exist than ever before.

B. Focus of This Segment of Session: This segment will address a number of practical and legal considerations in domestic and transnational distribution networks from a transactional perspective, with emphasis on recurring pitfalls and traps for the unwary under foreign laws and U.S. export regulations.

II. SELECT TRANSACTIONAL CONSIDERATIONS AND TRAPS FOR THE UNWARY:

A. Many Structures: Distribution strategies of U.S. companies are implemented through a variety of structures, from fully-integrated domestic and foreign subsidiaries or branch offices to independent sales intermediaries and retail outlets. Frequently, a variety of structures will be utilized among individual markets, or a combination of approaches in a given market, to address local considerations. Common independent sales intermediary forms may include general or specialized export management companies or trading companies, franchisees, sales agents, distributors and value-added resellers. The following discussion briefly addresses a number of issues relating to two of the most commonly selected form of sales intermediaries, namely independent sales agents and distributors.

B. Caveat Re: Foreign Variations: It is important to note at the outset that the titles used to describe various sales intermediary types and the legal implications of each can vary considerably from country to country, and care must be exercised in this regard in transnational relationships and "domestic" relationships where foreign application of rights is anticipated. Generally speaking, while outcome is ostensibly to be determined by substance of the relationship as evidenced by the written agreement and course of dealing of the parties as opposed to labels assigned to the parties in the agreement, the following practical considerations may justify adoption of key terminology to local statues and trade practices in appropriate cases:

1. Facilitate meeting of minds among business partners with diverse cultural and legal backgrounds;

2. Minimize the mis-application of unfavorable foreign laws by error or biased tribunal;

3. Maximize the probability that the foreign rules intended to govern your distribution strategy will be applied; and

4. Increase understanding in the foreign market as to the role of the intermediary and the scope of rights and duties expected when dealing with the intermediary.

C. Working Definitions: With the above caveat in mind, "agents" and "distributors" are distinguished according to the following factors:

1. "Distributor:" Generally speaking, a distributor:

a. Buys goods from the supplier for the representative's own account and resells the goods, profiting on its markup when it does so;

b. Bears the economic risk of resales, both as to price and collectability;

c. May warehouse and physically distribute the goods; and

d. Is an independent contractor with no authority to act on behalf of the supplier.

2. "Agent" or "Sales Representative:" In contrast, a commercial agent or sales representative:

a. Is compensated by a commission paid by the supplier on sales, and does not buy or sell for the representative's own account;

(1) Additional consideration may also be included, such as:
(a) Advertising costs;
(b) Start-up cost sharing or subsidies; and
(c) Subsidized marketing efforts (promotional materials in local language, trade show costs, etc.)

b. Does not bear the economic risk of failure of payment;

c. Takes orders for the supplier's product rather than purchasing and warehousing the goods; and

d. May or may not have express or implied authority to accept orders or take binding action on behalf of the exporter.

D. Structure Selection and Representative Protective Legislation: While a number of practical considerations influence which of these relationships is best suited for a particular supplier in a given market, a major legal consideration is that a number of countries have enacted legislation intended to protect the interests of sales intermediaries, and the applicability and scope of these measures may vary significantly among the structures available. As will be noted below on an issue-by-issue basis, these protective measures generally take the form of:

1. **Prohibitions or Restrictions Upon Termination, Which May Include Refusal to Renew or Extend Term:** Examples include:

   a. ”cause” requirements for termination or non-renewal:

      (i) vague and indefinite standards are common in the legislation (“material breach,” or “just cause”).

      (ii) Practice pointers:

         (a) reference the statute in the agreement and specify conduct or occurrences that are agreed as satisfying the standard.

         (b) quotas and other objective performance criteria are particularly valuable in these cases.

   b. minimum notice period mandated (discussed below)

2. **Post-Termination Compensation and/or Indemnity Requirements:**

   a. Default terminations generally avoid exposure

   b. Exposure to both compensation and indemnity can exist

   c. Amount of exposure can be difficult to assess due to lack of specificity in statute and inability to predict future market performance (an indication of the intermediary’s lost opportunity)

      (i) Practice pointer: Provide a formula in the agreement?

      (ii) Improved performance by the intermediary’s replacement increases exposure risk

   d. An amicable settlement at termination may be effective, but due to public policy basis for the requirement, confirm in advance that it will be enforced

3. **Other Restrictions** may be imposed upon the respective rights of the parties, such as:

   a. limits on license fees or royalty rates;

   b. impediment to registration of new representative; or

   c. prohibition of contract terms deemed to be “unfair” trade practices.

4. **Avoidance Techniques:** Techniques to avoid intermediary protection rules may include:

   a. **Selection of Different Structure:** Many jurisdictions have rules that protect commission agents, but do not have similar rules applicable to distributors except in the case of specific industries.

   b. **Choice of U.S. or Other Governing Law:** Discussed in more detail below, but generally will be ignored, at least as to the specific protectionistic terms under the local foreign law, due to strong public policy underlying the rules.

   c. **Arbitration Outside of Protectionistic Jurisdiction:** Coupled with a non-local law governing law designation, this can succeed in limited cases. See arbitration discussion below.

   d. **Belt and Suspenders:** A choice of favorable governing law and arbitration outside of the intermediary's market combined with a contractual clause that in effect provides a measure of the local statute's compensation requirement may minimize risk that (i) the intermediary will deny the termination settlement payment and challenge the arbitration clause locally, and (ii) if challenged locally, substantial excess exposure would exist beyond that provided in the contract.

E. **Written Agreement and Translations:** Considerations include:

1. **Overcoming cultural and linguistic challenges:**

   a. Between parties to the deal; and

   b. Future decision makers in disputes

2. **Local law requirements may require translated counterpart for:**

   a. Registration, if required; and

   b. Legalization for enforceability (notarization, etc.)

F. **Exclusivity Rights of Representative:** Practical and legal considerations determine whether an agent or distributor is going to be appointed as the exclusive representative for the supplier in a particular geographic market or with respect to a particular product line or customer/market segment.

1. **Practical Concerns:** From a practical standpoint, major concerns include:

   a. the risk to the exporter in looking to only one intermediary to effectively market its products;

   b. whether the intermediary will invest the time and effort necessary to effectively market and sell the products if it is competing with others to do so; and

   c. practical challenges of dealing with customer's central or regional buying arrangements that conflict with intermediary territorial assignments.

2. **Legal Concerns:** From a legal perspective, important concerns would include:

   a. Antitrust and unfair competition laws (next speaker will address);

   b. Protectionist rules triggered? If so, it will enhance the representative's rights in some regard (restrictions on termination, post-termination compensation rights, etc.); or

   c. Safeharbors for the supplier triggered? In some countries or regions such as the EU, granting exclusivity is a condition to qualify for safeharbors permitting otherwise prohibited or potentially unlawful terms in favor of the supplier (territorial restrictions, etc.).

G. Territorial Assignment: Another important issue with many legal and practical implications is whether to designate a geographic area that is either a binding limit on activities or a primary area of responsibility.

1. **Practical Considerations:** Important factors to consider include:

   a. Central or regional customer buying offices vs. originating office "local" to territory?

   b. Local post-sale support critical?

   c. Cultural considerations?

   d. Other contracts with assigned territories that must be protected from encroachment?

2. **Legal Considerations:** Important issues in this regard include:

   a. Export regulatory compliance—prohibited or restricted destination issues

      (i) At a minimum: build a fence with compliance mandate clause (See Section IV of these materials).

   b. IP concerns:

      (i) Trademarks:

      - Ensure limit to countries in which registered?
      - Require notice of sale outside of designated area to enable steps to register?

      (ii) Avoid exposure to high risk markets

   c. Antitrust and unfair competition laws (next speaker will address)

H. Term of Relationship: An agent or distribution agreement may provide for a term indefinite in duration or state a fixed term with or without renewal opportunities, or some combination of those options, such as a fixed term but early termination for convenience upon specified advance notice.

1. **Indefinite Term Concerns:** Agreements which are indefinite in duration are more at risk under the dealer protection rules of other countries, since such legislation generally represents an attempt to protect the expectations of local intermediaries from abusive

terminations by exporters. Accordingly, in some markets an agreement with no definite termination date may be deemed to:

a. be terminable only for "just cause", which in many situations is an uncertain standard, at best; or

b. require compensation of the intermediary upon termination, or both.

2. Mandatory Minimum Term? Some countries require a minimum term for agent or distributor contracts, and in such a case careful attention to termination rights is essential.

3. Mandatory Minimum Notice Period? Local law may mandate a minimum notice period, and a common approach is to increase the minimum notice period for "at will" terminations according to the number of years in the contract term or the number of years in which the relationship has existed.

4. Renewals If Stated Term: Renewal clauses are a frequent source of problems for exporters whose contracts do provide for a definite term. In some countries, an agreement with a stated expiration date may be treated as an agreement indefinite in duration and thus be subject to restrictions on termination if the agreement:

a. allows one or more automatic renewals without further action;

b. contemplates successive renewals; or

c. has actually been the subject of renewal previously.

Practice Pointer: Accordingly, once it has been determined that the foreign market in question is not governed by common law or legislative rules which would prevent the relationship from terminating upon the expiration of a stated term in the agreement, the provisions governing renewals should be carefully drafted to provide that:

a. no renewal or extension of term shall exist as a matter of right;

b. any renewal or extension of the term shall be effective only if by writing signed by both parties; and

c. while the terms of the existing agreement may be the basis for discussion among the parties, the respective rights and duties of the parties during any additional term shall be evidenced by a new agreement.

I. Standard of Performance: Even in a geographic market in which termination of the representative is allowed without "cause", specified performance requirements are advisable to facilitate a meeting of the minds and balancing of expectations, and, of course, to enable a shorter termination notice period for default terminations.

1. Best Efforts or At Least, Reasonable Commercial Efforts: At a minimum, the intermediary should be required to use "best efforts" (or at least reasonable commercial efforts) to fully and effectively market the products within the sales territory and to maximize sales of the products.

2. **Quotas:** Particularly in a market in which "cause" for termination will be required, objective and aggressive sales quotas or minimum purchase standards should generally be imposed upon the intermediary and integrated carefully with the default clause of the contract to permit termination or other relief if the quotas are not met.

   Practice pointer: Since defects in contract administration are frequent Achilles heels when the relationship becomes adversarial, it is often advisable to provide the client with prototype addenda forms specific to the contract to increase the probability that it will document occasional relief from quota or other performance standards lest waiver, estoppel or modification by course of dealing defenses be asserted to the client's detriment later.

J. Default and Termination Upon Default:

1. **Restrictions by Law?** As noted above, an exporter's right to terminate a foreign sales intermediary, even upon default, may be severely limited by the applicable foreign laws.

   A caveat: Although the intermediary's home country may not restrict termination, other markets within the territory may do so and may thus be triggered.

2. **Careful Drafting:** Accordingly, care must be exercised in drafting the default clause on a country-by-country basis to provide the exporter with the greatest flexibility possible in dealing with an unsatisfactory intermediary. When statutory or other standards for termination apply, those standards should be expressly incorporated into the agreement. In addition, objective standards, such as sales quotas, can give necessary teeth to otherwise vague legislative or common law standards qualifying as defaults and also minimize manipulation of outcome by a biased or weak tribunal.

K. Forum Selection—Revisiting the Basics With a Global Perspective:

1. **Multiple Possibilities:** Without an agreement to the contrary, parties to a dispute arising out of an international transaction are generally capable of instituting litigation in the courts of at least several different countries (places of contracting, places of performance, and residence for instance).

2. **Why Important?** The forum in which a dispute between the parties to a transaction is resolved is of critical importance due to the many legal and practical implications of the identity of the forum, including:

   a. **Outcome Affected:** The outcome may be affected, because (i) the substantive rules which may be applied to resolve the dispute may vary significantly from country to country, including the rules governing the choice of law governing the respective rights and duties of the parties, and (ii) the quality of the forum.

   b. **Convenience:** Another concern is the relative convenience of a particular forum to the respective parties due to location of witnesses or other evidence, familiarity with the procedures of the forum and its judges, distance from the parties, etc.

   c. **Finality:** Absent a treaty or trade agreement, a foreign tribunal in which you wish to enforce your U.S. or other foreign judgment may not be compelled to recognize it. Thus, selection of initial forum and likely locations of enforcement are key factors. See discussion below entitled “Dispute Resolution.”

3. **Designate?** Due to the importance of forum selection, well-drafted agreements involving international and domestic transactions generally designate a forum in which the parties agree in advance that disputes between them shall be resolved. However, instead of always designating your "home turf," forum selection analysis should proceed on a contract-by-contract basis in light of the foregoing factors, as well as the following:

   a. **Enforceable if Designate?** Even if a forum is designated by the parties in the contract, one of the parties may for strategic reasons later challenge the enforceability of the selection. Generally speaking, such a challenge may succeed if it is established that:

      (1) the contract was the result of fraud or adhesion;

      (2) in some jurisdictions, if substantial hardship and inconvenience would result;

      (3) if litigation in the designated forum would result in a violation of the public policy of the forum in which the clause has been challenged;

      (4) in some cases, if circumstances have drastically changed since the formation of the contract which would cause the remedy afforded by the designated forum to be inadequate (for example, the country designated is now at war with the challenger's country) or burdensome; or

      (5) if an ambiguity in the clause enables the reviewing forum to conclude that it is inapposite to the dispute at hand.

4. **Remedy Available?** Prevailing in the forum of your choice may be an empty victory if the remedies available to you at that point are not adequate. Concerns in this regard include:

   a. **Recognition of Foreign Judgments**: Once a litigant prevails it will then need to enforce the judgment by levying on assets, etc., unless the other party adheres to the relief granted. Finality and the process required to domesticate a foreign judgment varies globally, and the following are of particular importance:

      (1) **Treaty or Trade Agreement:** A foreign jurisdiction will not be required to accept a judgment as final unless the rendering country and the foreign jurisdiction are parties to a treaty or trade agreement absent a specific enabling statute of comity.

      (2) **Exceptions for Flaws and Public Policy:** Your adversary may claim that the original judicial proceedings were flawed by fraud, bias or unfairness, or lack of jurisdiction of the tribunal over the defendant or the subject matter of the proceedings.

   b. **Type of Remedy Desired?** Thought should be given to the type of remedy your client will need and the means by which that remedy may be obtained most effectively among choices of forums.

L. Choice of Governing Law—A Refresher With a Global Twist:

1. **Why Important?** As noted above, the substantive rights of the parties under an international sales intermediary contract in particular may vary significantly depending upon which nation's laws are applied

2. **Choice of Law Clause Enforceable?** The enforceability of a choice of law clause varies from country to country. Generally speaking, its enforceability will be determined by the rules of the forum in which it is challenged, although as noted above, practical and legal limits must be weighed.

   a. **Special cases:**

      (i) statute denies effect in contracts generally or as to specific type of relationship; or

      (ii) registration requirements in connection with a particular type of contract may be accompanied by efforts (overt requests or prolonged inaction) on the part of the reviewing officials to induce changes in choice of law and other contract terms that are not actually prohibited by foreign law.

   b. **An Overview of Other Cases:** Absent the above factors, choice of law clauses are generally enforceable where the law chosen:

      (i) has a substantial relationship to the parties and the international transaction in question; and

      (ii) if it would not result in the application of a rule that is contrary to a strong public policy of the jurisdiction in which suit is instituted.

      Practice pointer: See discussion below re: arbitration as a strategy to avoid otherwise overriding local law.

M. Dispute Resolution: International Arbitration?

1. **A Refresher:** Arbitration is frequently designated in transnational contracts as the governing dispute resolution mechanism for all disputes or only a designated class or type of disputes. In the absence of such an agreement in advance, arbitration will not be an option unless the other party consents at a later time.

   a. **Drafting Concern--Scope:** Since great exposure can exist under foreign intermediary protective legislation, a very broad arbitration scope clause is advisable. For instance, your adversary may assert that an arbitration clause covering “claims and causing of action arising under this agreement” does not apply to claims arising under agent protection laws.

   b. **Competition and Unfair Trade Practices Claims:** A tribunal may rule that arbitration is not appropriate in the case of assertions of rights or challenges to enforceability of contract clauses for alleged violations of competition or unfair trade practices rules.

2. **Advantage in Global Context:** There are a number of reasons, in addition to the perceived advantages of arbitration generally, why arbitration is frequently selected in transnational agreements, such as:

   a. **Fear of U.S. Litigiousness and Process:** Foreign trading partners fear both the litigiousness of U.S. parties and the process of litigating in the U.S. generally.

   b. **Culturally Acceptable:** In many foreign markets, arbitration is the means utilized in resolving local disputes, and they are thus comfortable with the concept.

      <u>NOTE:</u>

      (i) Local "Chambers of Commerce and Industry" and ministries with jurisdiction over the subject of various agreements often have arbitration bodies and processes that are favored locally.

      (ii) Asian parties in particular may expect a clause requiring some variation of mediation, even if only among executives from the respective contract parties, before proceeding to the full adversarial level.

   c. **Enforceability:** As of the date of this outline, 144 countries (including the U.S.) are parties to the UN Convention on Recognition and Enforcement of Foreign Arbitral Awards (known as the "NY Convention"), and trade agreements may in some cases provide for enforceability in additional jurisdictions.

   d. **Trap for the Unwary—Institutional vs. Ad Hoc Arbitration:** I am surprised by the number of transnational agreements that I review which designate institutional arbitration under one of the well-known international arbitration regimes, such as the International Chamber of Commerce, as opposed to ad hoc arbitration. I suspect in many cases this is because the client (or worse, their local general counsel) borrowed the clause from a form or received a recommendation from a respected colleague who did not know enough about the client's circumstances to warn about the cost implications, which can be quite shocking to clients in relation to the amount in dispute. In many cases, ad hoc arbitration under an internationally recognized body of rules, supplemented perhaps by appropriate contract provisions to tailor the process to the wishes of the parties (cost allocation, procedural matters, etc.) would better serve the client.

N. Select Other Issues: Under the time constraints of this session, it is not possible to discuss many other issues of importance that also represent traps for the unwary, but the following are notable examples:

1. **UN Convention on Contracts for the International Sale of Goods:** "Gap filler" legislation that applies unless disclaimed in contracts between parties of signatory nations, and in some cases, where the goods are to be delivered to a signatory destination. The U.S. is among the 73 signatories as of the date of this outline. Not all of our major trading partners are signatories (for instance, the U.K. is notably missing). The CISG is limited in scope, applying only to:

   a. Contract formation (caveat: no statute of frauds!);

b. Risk of loss;

c. Performance obligations of buyer and seller; and

d. Remedies for breach.

<u>Note:</u> The lost volume seller concept is not recognized in CISG.

2. **Incoterms:** International shipping terms that govern:

a. Seller's delivery obligation--allocation of responsibility between seller and buyer for:

(1) transport to export border
(2) clearing export borders (including duties)
(3) insurance
(4) freight
(5) clearing import borders (tariffs, etc.)
(6) delivery obligation

b. Risk of loss

c. Other practical effects include:

(1) foreign income/VAT taxation trigger (delivering in destination country vs. ex works); and

(2) choice of law rule triggers (performance by the supplier in country).

3. **Force Majeure and Excused Late or Non-Performance:** Special care should be exercised in drafting force majeure and other excuse clauses in transnational contracts in light of the increased risk of interference by circumstances or events that will not qualify as an excuse under applicable law.

Examples:

a. Good judgment in the case of SARs or other health or safety concerns may dictate restricted travel at times when travel is still lawful and possible.

b. Force majeure events experienced by a foreign component supplier may not excuse late performance by the supplier under the UCC or other applicable law.

III. INTELLECTUAL PROPERTY CONSIDERATIONS:

A. Transnational Considerations Generally: Valuable IP is often at risk in transnational distribution arrangements, and the following issues are among those that must be considered in addition to those at play in domestic relationships:

1. **Country Risk:**

a. Substantive protection available? Variances exist in the scope of innovations eligible for patent protection, the types of source identifiers that qualify as trademarks, and whether and to what extent trade secrets are protected. Contractual terms can add some comfort.

b. **Meaningful enforcement?** Many U.S. companies have experienced first-hand the lack of respect and meaningful protection afforded to IP in many countries.

2. **Civil vs. Common Law Jurisdictions:** A number of countries do not recognize common law trademarks and other IP claims, and such property rights are protected only to the extent provided by statute with registration or other affirmative steps required. See discussion below regarding trademarks.

3. **Foreign Associate Counsel:** Care must be exercised in associating local counsel abroad, even if the firm is a member of your firm's international association of firms or another major association of firms, especially in regard to IP matters.

a. **Training varies:** The training received by foreign attorneys and the requisites to their entering practice is not comparable in many cases to what we are accustomed. Even foreign attorneys that have obtained an L.M. from a respected U.S. law school may have surprisingly little legal training compared to an attorney who receives his or her J.D. from a U.S. school.

b. **Foreign branches of multi-national firms often have limited scope**

c. **Cultural and linguistic impediments make communications challenging**

B. Trademark Considerations:

1. **A Refresher—What is a Trademark?** Trademarks identify and distinguish the source of particular goods from the goods of all others (or in the case of service marks, the service provider). In addition to brand names and "taglines", in the U.S. and a number of other jurisdictions, product shape ("distinguishing guise" in Canada and some other markets), sounds (jingles, etc.), scents, and a range of other product or packaging features are entitled to protection as registered or common law trademarks.

2. **Common Law Rights?** A number of countries that are regular export or sourcing markets for U.S. companies do not recognize common law trademark rights and instead are "race to file" jurisdictions. The risk of prior third party registrations is compounded by frequent lack of use requirements (see below).

3. **Use in Commerce as a Condition to Registration?**

a. **U.S. Rule:** In the U.S., an application to register a mark requires the applicant to declare under penalty of perjury that it is either actually using or has a bona fide intent to use the mark in U.S. commerce. In an "intent to use" application, actual use must occur before the registration will issue, and the application will lapse if a use declaration is not timely filed.

b. **Use or declaration of intent to use is required in some other countries.**

**Actual use is not required in a number of these countries before registration issues.

c. **Many Other Countries:** Neither actual use nor intent to use is a condition to registration in many markets. This poses considerable risk to U.S. companies of strategic blocking or extortion by third parties, but carries with it the corresponding benefit that early registration is possible.

4. Continued Use Requirements to Maintain Registration?

a. U.S. Rule: Continuous use is required to maintain U.S. trademark protection, and inability to prove continued use exposes the registrant or common law claimant to loss of rights via abandonment.

(1) USPTO continued use declarations are required after the first 5 years of registration and again at the 10-year mark, and every 10 years thereafter as a condition to renewal.

b. Other Countries Are a Mixed Bag—Variations Include:

(1) No requirement to declare or prove use in order to renew.

**Oddly enough, this is so even in the case of several countries that require use as a condition to the initial registration.

(2) Third party cancellation attack: A number of countries allow a third party to cause cancellation of the mark for non-use (the time period varies), asserted either by petition to cancel or as a defense in an infringement proceeding initiated by the registrant.

(3) Use must be proven either to renew the mark or periodically during the term.

*****Mexico, for example, amended its trademark statute to abolish the 5-year continued use filing requirement, but filing a declaration of use constitutes prima facie evidence of continued use to defeat a third party claim of abandonment. Use is not a condition to registration.

5. Filing Options—Madrid vs. Regional or National Registrations: The U.S. is among the 75 countries that are parties to the Madrid Protocol allowing for registration of an international mark with WIPO (via registration in home market trademark office and related application to WIPO based upon that registration) and then designations of foreign member countries in which the mark is to be registered from time to time thereafter.

a. Madrid Pros and Cons:

(1) Cons include:

(i) Dependency Upon Home Registration: The 5 year rule;

(ii) Intended to be cheaper, but not always the case;

(iii) May take longer than a direct national filing;

(iv) USPTO may accept description that WIPO will later challenge as vague; and

(v) Regional filing may be better (EU community trademark).

(2) Pros:

(i) Avoid translation and legalization/authentication requirements;

(ii) Cheaper than national filing in some cases, due to local counsel charges primarily; and

(iii) Avoid the need to associate local foreign counsel in registration phase.

6. Import Protection Potential: The U.S. and some other markets allow a registered mark to be recorded with Customs officials and interdiction proceedings against infringing imports as a result.

a. "Success" requirements:

(1) Know the system and the players;
(2) Work the system aggressively—client buy-in is essential;
(3) Expect to do nearly all of the work; and
(4) Up the ante when possible—evidence implicating product safety?

IV. EXPORT CONTROL CONSIDERATIONS:

A. Big Brother is Watching: As noted in the Introduction to this Section, the export-import regulatory compliance hurdle is exacerbated by heightened U.S. government scrutiny since the tragic events of September 11 and the speed and ease with which regulatory agencies can now access information due to electronic filing and reporting requirements. As a result, more potential pitfalls and traps for the unwary exist than ever before.

B. Compliance is Challenging: Compliance with U.S. export controls is a daunting task for many, complicated by:

1. The myriad of statutes, regulations, and executive orders governing exports and related activities;

2. The sheer volume, complexity and in some cases, inconsistencies and errors, in the regulations;

3. The number of agencies that may have jurisdiction over the activities involved; and

4. The ease with which inadvertent violations may occur.

C. Regulatory Reach Simplified: A starting point in compliance analysis is to understand the potential reach of the regulatory structure, which is:

1. U.S "persons" wherever located;

2. U.S. source technology or goods wherever located;

Note: Foreign goods containing U.S. components are subject to U.S. export regulations unless "de minimus" U.S. content, as defined in applicable regulations.

**These rules are separate and distinct from the FTC's "made in the USA" labeling rules.

3. **U.S. Situs:** Goods or technology located in the U.S., regardless of origin.

D. Purposes For Export Controls: Comprehension and compliance with the maze of statutes, regulations, and executive orders that collectively control export activities are facilitated by understanding that one or more of the following main purposes are involved in each case:

1. **National security**: Limiting access to classified or other potentially dangerous technology or products by parties that are a threat to national security;

2. **Short Supply:** Preserving items in short supply;

3. **Economic Sanctions:** Implementing economic sanctions programs pursuant to bilateral or multilateral commitments by the U.S. or other U.S. trade policies;

4. **Punish and Deter:** Punishing past misconduct (and in some cases simple lack of cooperation with regulatory and enforcement personnel) and deterring future misconduct; or

5. **Collecting trade statistics**: Trade statistics are used for the development and implementation of U.S. foreign trade policy.

E. What Are The Stakes? The burden of compliance is significant, but the consequences on non-compliance are potentially devastating to the wrongdoer, as well as our nation, and include:

1. **Safety and Well-Being of Our Nation:** We all suffer if goods and technologies that are a potential threat to our nation are not controlled, even though we may dispute the extent or manner in which the controls are exerted.

2. **Criminal Penalties:** The U.S. Department of Justice prosecutes criminal violations. Where the requisite criminal intent is established (i.e., knowing or willful), sanctions for violation of the Export Control Act ("EAA") and implementing Export Administration Regulations ("EAR") for example, may include:

   a. Imprisonment for up to ten years; and

   b. Monetary penalties (per violation, not per transaction):

      (1) Company: Up to $1 million per violation or up to five times the value of the export

      (2) Individual: Up to $250,000 per violation.

3. **Civil and Administrative Penalties:** Administrative penalties can be imposed on a strict liability basis for violations proven by preponderance of the evidence. Under the EAA and EAR, these sanctions can include, among other things:

   a. Civil Fines of up to $100,000 per violation; and

b. Other administrative sanctions, including:

(1). Denial of export privileges;

(i) Standard denial order includes all commodities.

(ii) There is no limit on the length of denial authorized.

(iii) The denial will extend to:

(a) The denied person;

(b) “Related” persons; and

(c) Third parties dealing with denied person in an “export” transaction.

(2) Seizure of goods;

(3) Suspension or revocation of existing export licenses;

(4) Mandatory export compliance programs;

(5) Exclusion from practicing before the agency in the case of attorneys, freight forwarders, etc.; and

(6) ITAR debarment or suspension (i.e., loss of military and defense contract and export rights).

c. Statute of limitations: 5 years (28 U.S.C. §2462)

4. **Preventive Enforcement Measures:** Where a violation is imminent, the following actions may also occur:

a. temporary denial order; and/or

b. suspension or revocation of existing export license(s).

F. Select Export Control Laws: The following discussion will identify the two main agencies with jurisdiction in this area and the primary focus of the regulations they administer.

1. ITAR Regulations of the DDTC: The Directorate of Defense Trade Controls, Bureau of Political-Military Affairs, U.S. Department of State (“DDTC”) in accordance with §§ 38-40 of the Arms Export Control Act (“AECA”), 22 U.S.C. 2778-2780, administers the International Traffic in Arms Regulations (“ITAR”), 22 CFR §§120-130, and is charged with controlling the export and temporary import of defense articles and defense services covered by the United States Munitions List (“USML”).

2. EAR of the BIS: Many exporters are not subject to ITAR and are instead regulated primarily by the Export Administration Regulations (“EAR”) pursuant to the Export Administration Act, administered by the Bureau of Industry and Security of the United States Department of Commerce (“BIS”).

a. Primary BIS Responsibility: BIS administers:

(1) Anti-Boycott Regulations (15 CFR §760); and

(2) EAR (15 CFR §730, et seq.)

b. EAR Applicability—Assume Applicable Unless Exclusion Applies. It is often stated that the EAR regulates "dual use" items, meaning that it governs items that are primarily commercial in nature but which have possible military or defense applications. While indeed those items are covered and controlled by export licensing requirements in varying degrees, the EAR actually extends to all commercial goods and technology generally, except those items that are expressly excluded.

c. EAR Controls: If the product or technology is subject to the EAR, then extent of control applicable to a given transaction will essentially be determined by a variety of lists sequentially applied, as follows:

(1) Determination of the export control classification number ("ECCN") applicable to the goods or technology under the Commerce Control List ("CCL");

(2) End use restrictions;

(3) "Bad boy" lists; and

(4) Destination lists.

G. "Deemed Exports"—A Trap For The Unwary: Many are surprised by the extent to which export control laws such as ITAR and the EAR regulate access to information, not just tangible goods, even in cases where the information involved is not classified.

1. "Deemed Export" Rules Under the EAR: *Is the "export" of information within the US regulated*? Yes!

a. "Deemed Export" Defined: An export is deemed to occur upon a "release" of U.S.-origin "technology" or software source code to a foreign national in the US.

Note: Cryptographic technology and software source code are governed by special rules.

b. Effect:

a. Treated as an export to the recipient's "home" country (see below); and

b. "Deemed export" license required if transporting the same technology to the recipient's "home" country would require an export license.

c. "Release" = Access: a release is essentially access, and examples include:

(1) Visual inspection (reading plans, viewing US-origin facilities, etc);

(2) Oral exchange of information in the US; or

(3) Make available for practice or application under guidance of person with knowledge of the technology

d. "Technology" is Defined in Relation to a Controlled Product: Specific information for a controlled product:

(1) development;

(2) production; <u>or</u>

(3) use

Practice Alert: The highest applicable control level applies, even the specific product at issue is controlled under a less restrictive ECCN. *See* General Technology and Software Notes, Supp. 2 to 15 CFR §774.

e. "Foreign National" Triggers "Deemed Export" Rules: A person is not a "foreign national" for deemed export purposes if:

(1) US citizenship has been granted;

(2) Green card (permanent residence) has been obtained; or

(3) "protected person" under immigration law:

(i) political refugees; and

(ii) political asylum holders.

f. "Home Country" Rules (i.e. where the "deemed export" goes): A simplified summary (please see the rules):

(1) If citizen of one country but a permanent resident in other country:
- <u>Rule generally</u>: residence controls

(2) If citizen of more than one country:
- <u>Rule generally</u>: last citizenship granted will control

H. EFFECTIVE COMPLIANCE PLANS

1. The Stakes are High: As noted above, loss of export privileges and significant other criminal and civil sanctions can be imposed for violations of export controls, and administrative and civil penalties can be imposed without intent (i.e., strict liability applies). Defense of an investigation, even if proven unfounded, can be extremely expensive and disruptive, and the injury to good will from adverse publicity or from loss of business due to increasing company policies of supplier chain compliance can be significant injuries as well.

2. Detection Risk is Greater Than Ever Before: Detection of violations is more likely now due to many factors, including:

a. Aggressive enforcement and compliance initiatives by the agencies;

b. Accessibility of information to enforcement staff via AES (automated export system) and the internet generally;

c. Coordination among various domestic and foreign law enforcement agencies; and

d. Whistle blowing by disgruntled employees, competitors, or co-participants.

3. **Avoiding Common Causes of Inadvertent Violations:** Many violations are not the result of willful disregard of export control laws. Common causes of inadvertent violations include:

a. No written compliance program (a practical necessity);

b. Substantive defects in the compliance plan:

(1) Fails to trigger compliance action at all necessary stages;

(2) Missing or incorrect legal conclusions; or

(3) Has not evolved as regulations and/or product and technology changes occurred.

c. Compliance plan is not user-friendly:

(1) Should be tailored to specific company and its existing procedures, documents, etc., where feasible, as opposed to a canned plan or God forbid, the BIS prototype;

(2) A confusing or overly burdensome plan limits usefulness, encourages non-compliance, and increases training costs and transaction costs;

(3) Integration and training failures:

(i) Management must not waiver—make compliance an absolute, non-negotiable value;

(ii) Staff Integration is required at all levels, especially sales team and IP staff; and

* IP plan must coordinate with export compliance plan

(iii) Make sure all understand the consequences of non-compliance to the company and to them individually.

(4) Network integration:

(i) Foreign affiliates using accessing or using US source technology or products; and

(ii) Distribution network, especially foreign resellers and agents.

(5) Checks and balances missing or not followed:

(i) Internal to plan—needed; and

(ii) early detection is critical.

(6) Audit by outside expert not obtained regularly:

(i) commitment to compliance demonstrated and protected by audits;

(ii) early detection of violations; and

(iii) potentially significant mitigating factor if violation discovered.

(7) Protocol to handle suspected violations or investigative or enforcement agency communications is non-existent, inadequate or ignored:

(i) immediate and effective action is critically important;

(ii) natural tendency is to try to ignore or cover-up;

(iii) attorney-client communications and attorney work product privilege considerations;

(iv) many violations occur at this stage in the process:.

- Attempts to cover up—"willful" violation
- Misleading information given to investigative officers, and even worse, to defense counsel.

(v) first impressions are lasting—investigative and enforcement intensity and outcome can be greatly affected by very early stage mishandling by the exporter or its counsel, even if due to innocent error (incomplete or inaccurate response to agency inquiry, etc.).

I. "GET OUT OF JAIL FREE" CARD—MAY I HAVE ONE?

1. Don't We Wish: There is no sure way to avoid the penalties that may be imposed for even unknowing and unintentional violations of export control laws. The facts and circumstances of each case will determine the severity of the result, although warning letters are issued in lieu of other sanctions in the majority of cases resolved by BIS as a result of a voluntary disclosure as described below.

2. Factors That Affect Severity: The following are among the factors that are important in determining severity of consequences for violations:

a. Criminal intent or "self-blinding" vs. actual ignorance;

b. Sensitivity of products or technology involved;

c. Whether the transaction would have been permitted if the required license was requested, etc.;

d. Compliance efforts prior to violation:

(i) written plan?

(a) prepared by outside expert?

(b) compliance required?

(ii) past violations?

(iii) sought advice from outside compliance counsel, agency, etc., regarding the issue?

e. Conduct after the fact, including:

(i) voluntary self-disclosure? See below.

(ii) corrective action internally (discipline the involved employees, acquire training, implement or amend compliance plan, etc.)?

(iii) repeat the same violation even after detected?

(iv) manner in which investigative and/or enforcement proceeding initiated and handled.

f. Exporter identity, including:

(i) export experience?

(ii) small, closely-held start-up vs. more substantial company?

g. Attitude toward compliance: *how hard must we hit them to get their attention?*

h. Need to deter others

3. Voluntary Self Disclosures: An administrative process exists under each of the two export control regimes introduced above (ITAR and EAR) as well as others, such as the OFAC regulations for example, to permit an exporter that knows or suspects that it has committed a violation to voluntarily disclose it to the agency in hopes of receiving lenient treatment. There are many factors to consider and many traps and pitfalls for the unwary in this area.

a. Timing: Under the EAR in particular, a voluntary disclosure must occur before the information has been obtained from another source and an inquiry initiated.

b. Be Careful! Ensure that false statements or other cover-up attempts (incomplete disclosures of pertinent facts, for example) do not occur in the voluntary disclosure process, which will represent separate violations in and of themselves and may well result in culpability or at least allegations of involvement on the part of defense counsel.

c. **Effect:** A voluntary self disclosure is a "mitigating factor" under export control regulations. Under BIS internal policies for instance, among other things:

(i) "great weight" is given to the voluntary disclosure, and the beginning penalty calculation is reduced by 50%.

(a) the BIS internal policy is that it will not generally settle for less than fifty (50%) of the total possible penalties in cases that do not result from voluntary disclosures.

(ii) the voluntary disclosure will be publicly acknowledged in agency press releases.

d. **Waive attorney client privilege?** Prosecutors may well demand that attorney-client privilege be waived. There are many factors to consider in this regard, and this issue should be explored fully at the onset of the internal investigation.

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MANAGING DISTRIBUTION ARRANGEMENTS AT HOME AND ABROAD
--A MULTIDISCIPLINARY PERSPECTIVE

SECTION III:

MULTINATIONAL ANTITRUST REGULATION AND THE DISTRIBUTION RELATIONSHIP

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I. THE GLOBALIZATION OF ANTITRUST: From a small, niche field applied only in the United States and a few other select economies, antitrust regulation has grown to a global phenomenon. Over 110 countries now have antitrust regimes, and their laws apply within and without their own borders.

Major antitrust jurisdictions now include:

- The European Union, and all of its Member States
- South America: Brazil, etc.
- Africa: Egypt, South Africa, etc.
- Asia: South Korea, Japan, Pakistan
- China (a class of its own)

The huge number of antitrust regimes, and their overlapping jurisdictions has resulted in conflict and cooperation around the world.

- The U.S. Supreme Court has provided European litigants with the benefit of U.S. Style discovery (even though the EU, as amicus, asked not to be "helped"). *Intel v. AMD*, 124 S.Ct. 2466 (2004).
- The EU has blocked or imposed significant conditions upon the mergers of companies from the U.S. (GE/Honeywell, Boeing/McDonnell Douglas) and South Africa (Gencor).
- European and Asian executives have flown to the United States for the sole purpose of serving jail times, having committed their crime on their home soil (but affected prices in the U.S.).
- Jurisdictions around the world have imitated this practice by sending cartelists (from within the jurisdiction) to jail

- The EU and South Korea have taken on one of the U.S.'s most powerful companies -- Microsoft -- over the strong objection of the U.S. which had earlier settled with that company.

- Numerous international organizations aiming for harmony -- International Competition Network, OECD, ABA, etc.

The U.S., arguably, is no longer the leader.

- The leader will be, by definition, the jurisdiction whose legal regime is most active, regardless of the merits

- Where companies sell the same product in multiple jurisdictions, there is an incentive to comply with the most restrictive regime.

- European cases against Microsoft, Intel, Qualcomm, etc.

II. ANTITRUST REGULATIONS SIGNIFICANTLY AFFECT THE DISTRIBUTION RELATIONSHIP: Different treatment of three key distribution issues: resale price maintenance, loyalty rebates and territorial restrictions of sales. In the U.S., recent Supreme Court decisions have played important roles in most of these issues. At the same time, different cultural attitudes and legal regimes around the world have lead to often very different conclusions.

Lurking in the background is the growing threat of litigation in Europe.

A. RESALE PRICE MAINTENANCE.

1. THE UNITED STATES. Significant 180 degree changes in law recently. After a long history of condemning "RPM" as per se illegal, then making it difficult to prove "agreement" the U.S. Supreme Court did a 180 degree turn in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.***,** 551 U.S. 877 (2007). By a 5-4 decision, the Court ruled that it was no longer *per se* illegal for suppliers to agree with "downstream" purchasers on the minimum resale price.

But, filling in the perceived void, several states have moved to condemn the practice.

2. REST OF THE WORLD. In Europe, at the EU level resale price maintenance is treated as a "hardcore" price agreement, not subject to the so-called "block exemption" permitting many other vertical practices. Based on the historical concept of "pricing freedom," exemption condemns the restriction of the buyer's ability to determine its sale price." Commission Regulation (EC) No. 2790/1999, Article 4.

In April, 2009, Germany's federal cartel office imposed a 9 million Euro fine on Microsoft for "influencing" a retailer to sell a software suite at a specific price: manufacturer/retailer discussions "must not lead to a form of coordination where the supplier actively tries to coordinate the pricing activities of the retailer and thus retailer and supplier agree on future actions of the retailer." Global Competition Review ("GCR"), April 8, 2009. Recent activity in Pakistan as well, though with a horizontal component. GCR, April 29, 2009.

B. LOYALTY REBATES.

1. THE UNITED STATES. Above cost volume discounts designed to preclude competitor sales are generally lawful. E.g., *Concord Boat Corp. v. Brunswick Corp.,* 207 F.3d 1039, 1061-63 (8th Cir. 2000). In a controversial decision, the *en banc* Third Circuit held that above costs volume discounts could be unlawful where tied to required purchases of other products. *LePage's v. 3M*, 324 F.3d 141 (3d Cir. 2003), *cert. denied* 124 S.Ct. 2932 (2004). (Must ensure that such discounts meet the functional availability requirements of the Robinson-Patman Act, 15 U.S.C. § 13a).

2. EUROPE. European Commission investigation of Intel for granting discounts to purchasers who agree not to purchase from AMD or to delay launch of a product line incorporating AMD technology. Press reports that Commission has issued a draft ruling ordering fines and injunctive relief. GCR, April 23, 2009.

C. TERRITORIAL RESTRICTIONS.

1. THE UNITED STATES. Exclusive distributorships in a certain territory and prohibition on the right to sell outside that territory are generally lawful. *GTE Sylvania Inc. v. Continental T.V., Inc.,* 433 U.S. 36 (1977).

2. EUROPE. Similar principles apply, but the "safety zone" is narrower. The Commission will strictly scrutinize an argument that territorial restrictions are necessary to incentivize a dealer and prevent free riding. With certain key exceptions, vertical territorial restrictions are exempted from the Block Exemption's, meaning they are treated as presumptively illegal. Commission Regulation (EC) No. 2790/1999, Article 4. The clearest case is that where there is more than one distributor in a territory, the "incentive" argument will not work, and other distributors may not be prohibited from selling into the territory. *E.g. Volkswagen*, OJ 1998 L124/60.

The driving force is that the key policy behind European competition law is the desire to integrate into one market.

III. TWO BACKGROUND ISSUES, WHICH AFFECT THE DISTRIBUTION ENVIRONMENT:

A. LITIGATION. In the United States, after discussion of "Civil Justice Reform" under Bush I, the Courts have given some recognition to the anticompetitive effects of large scale, treble damage, discovery provoking litigation, and have issued key rulings scaling it back,, *Credit Suisse Securities v. Billing*, 551 U.S. 264 (2007); *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007).

Europe is moving in the other direction, trying to encourage private litigation as an additional tool to build a competitive marketplace. Commission of the European Communities, White Paper on damages actions for breach of EC antitrust rules (April 2, 2008); Green paper on damages actions for breach of EC antitrust rules (December 19, 2005).

B. DISGUISED PROTECTIONISM? A country would have every theoretical incentive to subject importers to more restrictive antitrust regulation than domestic suppliers -- profits go the foreign importer, and costs are paid by domestic consumers. In the U.S., export cartels are legal. 15 U.S.C. § 62. According to Intel and the Wall Street Journal, it is no coincidence that Europe's biggest recent Abuse of Dominance investigations (Microsoft, Intel, Qualcomm) have been against U.S. companies.

China and Pakistan have recently applied their antitrust laws to prevent Coca Cola from owning a domestic "national champion" (China), and to allow a domestic supplier to break into the McDonald's market in the face of an exclusive McDonalds/Coke arrangement.

When planning distribution arrangements abroad, be prepared to find disguised protectionism.

IV. EUROPEAN LAW, BEHIND OR AHEAD OF THE CURVE? Many have been tempted to explain European/U.S. differences through less sophistication/experience on the part of the former. This explanation is not consistent, however, with the much more sophisticated state aid regime in Europe.

Europe recognizes that we cannot regulate competition among private companies, without also dealing with the problem of aid from the state. Treaty establishing the European community, Article 87. As the bank and auto industry subsidies have recently made vividly clear, there is no such regime in the United States.

Will Obama Supreme Court/Administration appointees move to a more restrictive, European style regime?