

Notes and Questions

Distribution Agreement (I)*

(1) Assume that products are lost at sea during a violent storm. Which party to the distributorship agreement bears the risk of such loss? What result if the products are damaged in storage in the United States are awaiting shipment? Or suppose that the Common Market imposes a high tariff or a quota on the importation of manufacturer's products. Which party bears the burden of the increased cost or the reduced number of items imported? Would it make any difference if the source of the loss was United States export controls or limits on manufacture due to scarcity of materials? How would you alter this provision to shift any or all these risks? Why would you pick one party over the other to bear such risks?

(2) Compare Article I(C) with Article VIII (8.1) of the draft distributorship agreement. Any problems?

(3) Note that under Article II(2.1), Boilo grants to Argen the right to distribute the products throughout the Federal Republic of Germany? Suppose Boilo enters into a distributorship arrangement with a distributor in France knowing that the French distributor intends to export some of the products to Germany? Has Boilo violated its agreement with Argen?

Suppose Argen wished to sell Boilo's products outside of Germany in other European countries. Under the draft distributorship agreement, could it do so? Suppose Boilo develops new products? Does Argen have the right to distribute these throughout Germany?

(4) Consider, from the perspective of a counsel for Boilo, the provisions of Article III, Section 3.3 and Article IV, Section 4.3 and 4.4. Are they satisfactory? If not, how would you redraft them?

(5) With respect to Article VI's provisions on warranties and disclaimers it should be noted that Germany is a party to the United Nations Convention on Contracts for the International Sale of Goods (CISG). The CISG may or may not apply to the agreement between Argen and Boilo because that agreement may or may not be considered a contract for the sale of goods within the meaning of Article 1(1) of the Convention. In the event that the CISG were judged applicable, Articles 35 and 36 of the Convention would then come into play. While on the face of it Article 35 covers much the same ground as UCC §§ 2-313 through 2-315, it does not explicitly draw a distinction between express and implied warranties. Because of this and because the Convention will undoubtedly be read by courts in different countries against the background of very different legal traditions concerning warranties, great care will have to be taken by those courts if the Convention's goal of uniformity is to be achieved in this important area. What is critical, of course, is that the American lawyer cannot, in spite of the facial similarities between Article 35 and the UCC, rely on the Convention being interpreted in

* Adapted from Swan & Murphy

accordance with American traditions under the UCC if the issue ends up in a foreign court. The question may then arise whether a court in the United States or elsewhere will honor a choice of law clause selecting the law of the other applicable state party to the Convention if its attention is brought to the possibility of a disparate interpretation of the Convention by the courts of that state.

(6) Note further the disclaimer of warranties in Article 6.3 of the draft distributorship agreement. This was obviously drafted to meet the requirements laid down by § 2-316 of the UCC. Note again, however, that even if the CISG is applicable to the distributorship agreement, questions pertaining to the *substantive* validity of that agreement will, by reason of Article 4(a) of the Convention, continue to be controlled by the applicable domestic law. Hence a choice of law clause remains an important provision of the agreement.

(7) Evaluate the termination provisions in Article VIII of the draft distributorship agreement. Are they consistent with the German Statutes reproduced above? Do these statutes apply to the draft distributorship agreement? Does Article XI (Section 11.4) of the draft distributorship agreement resolve any problems?

(8) In considering the German statutes reproduced above, it should be noted that, while these statutes protect "commercial agents," they do not specifically refer to, and there are, at this writing, no German legislative provisions governing distributorship agreements. However, the German Supreme Court has ruled that these provisions apply by way of analogy to *exclusive* distributorships. Query whether the ruling would be the same in the case of a nonexclusive distributorship agreement.

In Belgium, statutory provisions regarding distributors are applicable only if the arrangement is exclusive, quasi-exclusive, or has an indefinite duration. Belgian courts, moreover, will "stretch" their construction of a distributorship agreement to find it exclusive or quasi-exclusive or of indefinite duration. These provisions are often applied by analogy to agents as well as to distributors.

(9) The German Courts have handed down decisions relevant to termination of distributorship agreements. In particular, in the *Decision of 30 January 1961*, a German plaintiff had acted as general representative in the Federal Republic and West Berlin for defendant, a Netherlands Corporation, which produced bathing suits and knitted garments. The German Supreme Court held plaintiff was not entitled to a settlement from defendant under Commercial Code Section 89b when the contract between them provided that all litigation involving the contract was to be brought in a Netherlands court and that Netherlands law should govern all legal relations between the parties arising from the contract. The Court rejected plaintiff's contention that application of Netherlands law in this instance would be *contra bonos mores* or contrary to the object of a German law within the meaning of Section 30 of the Introduction to the German Civil Code or a juristic act contrary to a statutory prohibition under Section 134 of the German Civil Code. The court also rejected plaintiff's argument *ex contrario* based on Commercial Code Section 92c that with respect to a commercial agent with a domestic branch an agreement for foreign law and a foreign forum is ineffective because of the mandatory nature of

Commercial Code Section 89b.

In early decisions German courts were willing to grant a distributor a cancellation settlement under Commercial Code Sec. 89b only if he could show that he was completely dependent upon the principal like a typical commercial agent. If the distributor expended substantial amounts of his own capital during the term of the distributorship, he was not regarded as being “in need of protection.” However, the Bundesgerichtshof (The German Supreme Court) recently ruled that the distributor's need for protection is irrelevant to his right to goodwill compensation. This right exists from the moment the relationship between manufacturer and distributor becomes more than a seller-buyer relationship and the distributor is contractually obligated to perform tasks and live up to the standards normally applicable to agents.

(10) A number of countries have laws that limit or circumscribe the termination of distributorship arrangements, and some are more stringent than those of the Federal Republic of Germany. Costa Rica, for example, has a non-waivable statute that mandates an indemnity be paid equal to four months average gross profit for each year or fraction thereof that the distributor agreement has been in force, if a foreign supplier unilaterally terminates or refuses to renew a distributorship agreement for a definite period at the end of the original term. The indemnity can be as high as nine years average gross profit of the distributor, and the supplier has to repurchase the inventory of the terminated distributor at prices set by the Costa Rican Government. For its part a Costa Rican distributor can terminate a distributorship agreement and claim compensation for a wide variety of reasons. A foreign supplier can terminate without paying compensation only for “just cause,” a concept defined narrowly by the statute.

Although this would not be the not the case in Costa Rica, some contractual provisions may avoid or at least mitigate the application of local law protecting the distributor. Some suggested examples for inclusion as termination provisions are:

- (a) The inclusion of a notice period for unilateral termination. Such periods are often required by statute or judicial doctrine.
- (b) A contractual provision for the automatic termination of the distributorship agreement one day before the effective date of a new protective statute in the country of the distributor.
- (c) A specific contractual list of obligations of a distributor which, if not met, may be used to define “just cause.” Such a list may include sales quotas or objectives.
- (d) The express waiver by the distributor of the benefits of local protective legislation.
- (e) The choice of the law of the country of the foreign manufacturer, or of a third country which does not have protective/legislation or judicial doctrine.

- (f) The use of an indefinite term, or a specific term. The laws of some countries are by their terms inapplicable to contracts of indefinite term or contracts for a specific term.
- (g) The use of a provision that requires that enhancements to the value of a distributor's goodwill inure to the benefit of the foreign supplier.
- (h) The use of a provision expressly stipulating that the foreign distributor is neither the employee nor the agent of the U.S. manufacturer.
- (i) The appointment of a non-exclusive distributor. Some foreign termination laws only apply to exclusive distributorships. Furthermore, the right to appoint a second distributor can obviate the necessity of terminating a distributorship agreement in the first place.
- (j) The express provision for the existence and amount of a termination indemnity.

(11) What advantages, if any, are there in submitting disputes arising under the agreement to arbitration? Would Argen be likely to resist Article IX's choice of New York as a place of arbitration? What arguments might Boilo advance to justify such a selection? In light of the adoption by both the United States and the Federal Republic of Germany of the U.N. Convention on Arbitral Awards, should Article IX be redrafted to improve its enforceability?

(12) An important consideration in the drafting of a distributorship agreement is the tax implications. In particular, the question arises whether Boilo might be subject to German taxes on the sale of its products by Argen. Here the Convention Between the United States and the Federal Republic of Germany for the Avoidance of Double Taxation with Respect to Taxes on Income comes into play. Article III of that Convention, in pertinent part, provides that “industrial or commercial profits of an enterprise of one of the Contracting States shall be exempt from tax by the other State unless the enterprise is engaged in trade or business in such other State through a permanent establishment therein.” Under Article II(l)(c)(ee) of the Convention, “[a]n enterprise of one of the Contracting States shall not be deemed to have a permanent establishment in the other State merely because it is engaged in trade or business in that other State through a broker, general commission agent or any other agent of an independent status, where such person is acting in the ordinary course of business.”

(13) Deliberately omitted from the draft of distributorship agreement, for purposes of illustrating its need, is a *force majeure* clause. Such a clause might read, for example, along the following lines:

Neither party hereto shall be liable to the other on account of any loss, damage or delay occasioned or caused by strikes, riots, fire, insurrection, war, peril of the seas, embargoes, failure of carriers, compliance with any law, regulation or other governmental order, import or export prohibitions or other causes beyond the control of the affected party,

despite its best efforts to insure performance of all its obligations hereunder.

(14) An equally important provision omitted from the draft distributorship agreement is a clause along the following lines:

Distributor represents and agrees that it has not offered, given, promised to give or authorized giving, and will not offer, give, promise to give or authorize giving, directly or indirectly, any money or anything else of value to any government official, political party, political official or candidate for political office in connection with its activities hereunder.

Such a provision is advisable because of the U.S. Foreign Corrupt Practices Act (FCPA), which requires U.S. suppliers to ensure that those who act on their behalf do not engage in bribes or other forms of corrupt activity. Another advisable step to assure compliance with the FCPA is to exercise care in checking distributor references and reputations.

(15) Missing from the draft distributorship agreement above but, depending upon the particular circumstances, worthy of consideration for possible inclusion are provisions regarding liability for local taxes, the right of the manufacturer to repurchase a distributor's inventory upon termination, trademarks and patents, freight, insurance, handling and other similar costs, product liability, and import and export procedures. Also, in drafting a distributorship agreement one must be especially cognizant of the importance of the local law of the distributor's country.