LEXOLOGY
Getting the Deal Through

DISTRIBUTION & AGENCY 2023

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David Koch

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Global overview

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It is wonderful how much of global commerce is simply moving products from point of origin to point of ultimate use. But 'simply' is not an apt term. Moving products through the supply chain – especially across borders and oceans – is a complex dance of actors, resources, strategies and coordination. And a similarly complex set of contracts, laws and regulations tries to impose order and regularity on the entire enterprise.

Distribution law is a candy shop for those who love the challenge of applying legal principles to facts. The range of products and services is as diverse as it can be. The companies are at all stages of business life, from start-up to multinational behemoth. The toolbox of solutions for manufacturers and suppliers to reach their ultimate markets is well stocked. The gamut of legal issues (to say nothing of cultural and commercial) demands an open and agile mind. How could a distribution lawyer ever get bored?

Lexology Getting The Deal Through – *Distribution & Agency* proves that you won't get bored. It showcases the variety of legal issues a supplier, its distribution partners and their lawyers could confront. Glancing at any country chapter is enough to verify that distribution lawyers must know at least a little about a lot of things. For example, what's involved in setting up a distribution subsidiary in-country? How much freedom is there in contracting with an independent distributor? What controls over pricing, territory, customers and online sales are permissible? What are the obligations to consumers for product safety, advertising and warranties? Can the supplier and distribution partner collect and share data without restriction? Where is the line between 'employee' and 'independent contractor'? How do suppliers and distribution partners normally resolve disputes, and what are the alternatives?

Lexology Getting The Deal Through – *Distribution & Agency* equips you with an efficient reference to help spot issues that may need closer study in a particular country. By using a consistent question and answer format, it also makes it easy to compare a particular issue across countries. And of no less importance, Lexology Getting The Deal Through – *Distribution & Agency* provides a roster of qualified local counsel who can help businesses navigate new markets and relationships.

You will need the local counsel. A general understanding of the legal environment in a particular country is not enough, by itself, to guide businesses through the distribution options available – particularised advice is always recommended. And even if a general understanding of the legal environment were sufficient, distribution lawyers must balance legal issues with non-legal: the clients' brand recognition, financial objectives, risk tolerance, management culture, preferred ways of doing business, industry customs and local commercial practices, among other factors.

Commercial practice in the United States, as in other countries, is that the term 'distribution agreement' refers to an agreement between a manufacturer or supplier and a reseller of the manufacturer's or supplier's goods or services. But in the United States, the reseller is usually called a 'distributor' if it resells to other businesses for further resale, whereas it is usually called a 'dealer' (or sometimes 'retail distributor') if it resells to end users. For example, a non-US automobile manufacturer typically sells its vehicles to a national distributor for the United States, which resells the vehicles to local automobile dealers, who in turn sell vehicles to consumers. In the United States, there is no regulatory scheme applicable to distribution agreements as a general class. In most cases, parties are free to enter into a distribution relationship on whatever terms they choose, without any mandated terms or formalities or oversight by any government body. Unless a special industry statute applies, general principles of contract law will govern.

In other countries covered in this volume, the general description of the legal environment for distribution agreements will be much different from the US description. Suppliers and distributors may encounter mandatory contract clauses, tighter competition laws, goodwill indemnities for termination of distributors, distinct rules for e-commerce versus offline sales and for single-brand versus multi-brand resellers, comprehensive data protection requirements, and unfamiliar court systems, to name just a few variations.

These differences can go to the core of a distribution relationship, affecting the parties' costs, levels of control, sharing of revenues, allocation of business risks and tax consequences – which in turn will determine the ultimate success or failure of the relationship. Distribution lawyers therefore need the ability to demystify the differences between countries and to clarify the legal risks and distribution options in each. The objective of Lexology Getting The Deal Through – *Distribution & Agency* is to make distribution lawyers more effective strategists and collaborators with their clients in bringing products and services to market.

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Austria

Veit Öhlberger and Heinrich Kühnert
DORDA

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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.

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.

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).

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.

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).

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.

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.

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.

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.

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.

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.

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.

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.

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, the Austrian courts have generally not been receptive to arguments that RPM may be necessary to prevent free riding.

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.

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.

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.

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).

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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.

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*).

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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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.

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.

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. The legislative process will be completed before summer 2023.

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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 Belgium to import and distribute its products in Belgium.

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

A foreign supplier may be a partial owner with a local company of the importer to import its products.

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 appropriate business entities for foreign suppliers to import products are entities that limit the liability of the shareholders. In Belgian law two different forms of business entities enable this:

- the Besloten Vennootschap (BV) or Société à Responsabilité Limité (SRL) – no minimum capital requirement; and
- the Naamloze Vennootschap (NV) or Société Anonyme (SA) – minimum capital of €61,500.

The NV or SA is the company form most suited for entities that are listed on the stock exchange and the BV is the most suited form for entities that are not listed on the stock exchange.

The law that governs entities established after 1 May 2019 is the Belgian Company and Associations Code (Wetboek van vennootschappen en verenigingen/Code de droit des sociétés et associations). Some parts of the old Belgian Company Code (Wetboek van vennootschappen/Code de droit des sociétés) might still apply to companies established before this date.

Both these company forms are established by a notary deed that will need to be published partially in the Belgian State Gazette. This publication will also contain the bylaws of the company. Note that with the new Belgian Company and Associations Code, the capital requirements have changed and thus the importance of the financial plan has grown.

Restrictions

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

Belgium does not limit foreign business from operating in its jurisdiction, nor does it limit foreign investment of ownership of domestic business entities.

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 local entity that distributes its products, as long as this does not infringe competition law.

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?

When importing products into the European Union, an import tax must be paid on the product. In Belgium, Value Added Tax must also be charged to the clients and transferred to the VAT administration. The general VAT rate in Belgium is 21 per cent, but for some products the VAT rate is 6 per cent or 12 per cent.

When a company that is owned by a foreign business has an establishment in Belgium, it must pay corporate tax, which amounts to 25 per cent as of 2020 and is lowered to 20 per cent for the first €100,000 of profit for small companies. Note, however, that the Belgian Income Tax Code allows for many deductions, such as costs and investments, before this percentage is applied.

A foreign individual will not be subject to corporate tax but will be subject to income tax in Belgium according to the double tax treaty that Belgium has concluded with the state of origin of that individual. If the individual operates through a company, then the individual will have to pay an advance levy on income derived from dividends.

LOCAL DISTRIBUTORS AND COMMERCIAL AGENTS

Distribution relationships

7 What alternative distribution relationships are available to a supplier?

Several distribution relationships are available to a supplier in Belgium. Suppliers of products or goods can choose from the following distribution options:

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- First, distributors can choose for direct sales to customers without any involvement of third parties. They could opt to make sales through either in-house commercial representatives or a designated sales team. Note also that commercial representatives can benefit from certain rights: for instance, clientele indemnity if their employment agreement is terminated for convenience.
- Second, suppliers can opt to commercialise their goods or products through the intermediation of commercial agents. A commercial agent is a self-employed intermediary who negotiates a sale or purchase of goods or services on behalf of another person, called the principal. The benefit of working with an agent is that the supplier retains direct contact with its customer and also has greater control over elements such as prices and marketing efforts.
- Furthermore, suppliers also have the choice to sell their products or goods to distributors, who re-sell these goods or products to customers. In this case, the sales are realised first between the supplier and the distributor, and afterwards between the distributor and the customer. The determining factor of a distribution agreement lies in the presence of sustainable and structured cooperation through which those sales are made. Hence, mere consecutive sales are insufficient to qualify as sales made in the framework of a distribution agreement.
- Finally, suppliers or manufacturers can also opt for franchising, based on which distributors would re-sell products while using the franchisor's trade name or business formula. Through franchising, suppliers can significantly increase their presence and growth in a specific market while minimising their economic risk and investments, as these are materially borne by the franchisee. In exchange for a franchise fee, the franchisee then benefits from a certain company formula and know-how, together with permanent assistance and close cooperation with the franchisor. Usually, the franchisee has to comply with numerous obligations of the franchise, laid out in a manual.

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 Code of Economic Law, Book X (Wetboek van Economisch Recht/Code de Droit Economique) regulates the relationship between a supplier and its distributor, agent or other representative.

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?

There are restrictions for suppliers to terminate a distribution relationship in some cases. In general, on the one hand, a contractual relationship of an agreement of a definite term cannot be ended without cause before the end of this term, unless the agreement provides

for such a termination. On the other hand, agreements of an indefinite term can be ended at any time without cause, given a reasonable notice period, as parties cannot be bound to an agreement forever.

Indefinite and definite term agreements can be ended for cause. A party may not decide this by itself but must introduce court proceedings so that the judge will end the agreement in question. However, for commercial agency agreements special provisions apply. A commercial agency agreement can be terminated for cause exceptionally when any further cooperation between the parties becomes definitively impossible or when one of the parties commits a material breach. This termination right is restricted by short and strictly defined delays and formal requirements.

For agency agreements (articles X.1 to X.25 Code of Economic Law) and for exclusive distribution agreements legislation (articles X.35 to X.40 Code of Economic Law) another more protective regime is applicable that we will discuss below.

As stated above, for exclusive distribution agreements, title 3, Book X of the Code of Economic law does not provide for a specific mandatory notice period but contains some mandatory rules on termination. These specific provisions only apply to exclusive agreements concluded for an indefinite period of time. However, when a distribution agreement for a fixed term has been renewed or modified on two occasions, any further renewal or modification is deemed to have been accepted for an indefinite period.

According to article X.36 of the Belgian Code of Economic law, a principal can only terminate an exclusive distribution agreement concluded for an indefinite period of time by respecting a reasonable notice period or paying a compensatory indemnity, unless the distributor has committed a 'serious breach'. Article X.36 of the Belgian Code of Economic Law provides also that parties can only agree on the duration of the notice period once the agreement has been terminated by one of the parties.

The notice period should be 'reasonable', which means that it must allow the distributor to reorganise its activities. To determine a reasonable notice period, the court will take into account several aspects of the distributorship, such as the duration of the distributorship, the importance of the distribution activity in the overall activities of the distributor, the size of the territory, the specific investments made by the distributor that are linked to the distributorship, and the market share of the brand and the distributed products. On the basis of such criteria, the notice period granted by the Belgian courts usually ranges between three months and 24 months, with a few exceptional cases where 36 or 48 months were granted (for instance, in the automotive sector when the distributorship represents the entire activities of the distributor).

As stated above, a fixed-term exclusive distribution agreement cannot in principle be terminated before its expiry date. Under mandatory law, in the case of a fixed-term exclusive contract that would be terminated before its normal expiry date, the distributor is entitled to compensation for costs incurred and loss of profit, to make up for the situation it would have been in if the principal had not wrongfully terminated the agreement.

Finally, commercial agency agreements with an indefinite term can be terminated without cause by granting a minimum notice period, which varies according to the duration of

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the agency agreement. Per started year, one month of notice should be granted, with a maximum of six months. This principle also applies to agency agreements of a definite duration when the principal is contractually able to terminate the agreement earlier than the end of the definite term. In the case of agency agreements, the same principle applies as with exclusive distribution agreements of an indefinite term: if the notice period is not respected, the principal must pay a termination indemnity.

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

When an exclusive distribution agreement of an indefinite term is ended without cause, the principal should grant the distributor a reasonable notice period. Should this notice period appear to be insufficient, the distributor will be entitled to a compensatory indemnity. Generally, this 'compensation in lieu of notice' or compensatory indemnity is calculated on the basis of 'semi-gross profit'. This is generally calculated on the basis of the average net profits generated over the last three years before the notice of the dealer's distributor before taxes, increased by the irreducible overhead costs that the distributor cannot avoid or eliminate upon termination of the agreement by the principal. The latter cost could include items such as rent, heating, lighting, maintenance of premises and equipment, and insurance. The semi-gross profit per month will then be multiplied by the number of months corresponding to the missing months of the 'reasonable' notice period.

Furthermore, additional indemnities may be due for distribution agreements that fall within the scope of Title 3, Book 10 of the Code of Economic law. Pursuant to articles X.36-X.37 of the Code of Economic law, the distributor might be entitled to additional indemnities (reimbursement of costs and investments, goodwill indemnity, redundancy costs of employees):

- Reimbursement of costs and investments, incurred by the distributor within the scope of distributorship, which will continue to benefit the principal after termination (eg, investments for long-term advertisements, conferences).
- Goodwill indemnity or loss of clientele: this compensates the value of the clientele built up by the distributor provided that there is a significant increase in the clientele or business and that those customers will remain with the principal after termination of the distribution agreement.

The Code of Economic law does not set out any calculation criteria. When determining this indemnity, the courts take into account several parameters, such as the evolution of the turnover and the number of clients brought by the distributor, and the duration of the agreement. It is to be noted that the court may adjust this indemnity 'in fairness' (ex aequo et bono). It usually amounts to between 1 per cent and 10 per cent of the annual turnover of the distributorship or between three and 12 months' gross profit of the distributorship. Sometimes it is calculated on the basis of the net profit, in which case it can be up to 24 months' net profit. This is generally calculated from the distributor's average annual profit generated with the contract products over the last three years before the notice.

- Redundancy cost of employees that the distributor had to dismiss as a direct result of the termination of the agreement. These costs are only to be compensated if the employees are dismissed by the distributor due to the termination by the principal of

the agreement and if their notice period is longer than the notice period granted by the principal.

The terminated distributor needs to prove that a certain employee had to be laid off because of the termination, which means that the personnel were specifically hired and active for distributing the relevant products in Belgium. Partial compensation could be claimed in case it is not all related to the terminated distribution. Such termination costs can be high, depending on the factual circumstances. The distributor must in principle give notice to the personnel as soon as the distribution is terminated, although there could be exceptions where it is acceptable that the distributor waits because it needs the qualified staff to reorganise its business.

When a commercial agency agreement of an indefinite term is ended with an insufficient notice period without cause, the party terminating must pay a termination indemnity. This indemnity consists of the agent's remuneration, calculated on the basis of the average amount of commissions earned during the 12 months prior to termination, which would have been due if the notice period had been granted. A goodwill indemnity may be due if certain conditions are met. The latter is limited to one year of commission calculated on the basis of the average amount of commission earned during the five years prior to the termination. If the company terminates a commercial agent for convenience reasons, this agent may also claim further compensation, in addition to a notice period (or compensatory damages) and goodwill indemnity. This could include specific investments (that are not yet written off), costs of terminating personnel and terminating subagents. As agents are very often individual persons or small companies and in addition only need to find customers for the company, not sell or deliver the actual goods or provide after-sales services etc, we do not encounter this very often in practice. Discussions with terminated agents are mostly focused on the goodwill indemnity criteria.

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 distribution contract provision prohibiting or restricting the transfer of the distribution rights to a third party will in principle be allowed.

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 are no restrictions on the enforcement of confidentiality provisions in distribution agreements in Belgium specifically. It is even good practice to include confidentiality obligations in distribution agreements as a confidentiality obligation is one of the measures

needed to ensure trade secret protection in Belgium. It is important to ensure that the confidentiality obligation will last some time longer than the duration of the agreement, without providing an indefinite term. The duration itself should be determined according to the subject matter of the agreement. Moreover, the confidentiality clause should not have too broad a scope, as the clause might not be valid if it exceeds the legitimate interest of the disclosing party. Therefore, it is important to exclude the following information from the information to be kept confidential: information that the receiving party already knew independently of the disclosing party prior to the conclusion of the agreement; information that the receiving party discovers through a third party or develops itself; and information that is publicly available or generally known.

Competing products

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

Distribution agreements often contain non-compete obligations, which are generally enforceable to a certain extent. Such obligations may not limit the freedom of trade and industry too drastically (case law and legal authors argue that any non-compete arrangement should therefore be limited in time, territory and type of business). Moreover, Commission Regulation (EU) No. 2022/720 (the block exemption regulation for vertical agreements) excludes certain non-compete arrangements (such as non-compete obligations that are tacitly renewable beyond five years without the effective right to re-negotiate or terminate the agreement with a reasonable notice period and at a reasonable cost).

For commercial agency agreements specifically, the Belgian Code on Economic Law provides that non-compete clauses will only be valid if and to the extent that:

- they are stipulated in writing;
- they are limited in scope: they should relate to the type of goods entrusted to the commercial agent by the principal;
- they are limited in territorial scope: they should be limited to the geographical area entrusted to the commercial agent by the principal; and
- they are limited in time: they may not extend beyond a period of six months after the termination of the contract.

Prices

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

Determining (minimum) prices is a hardcore restriction under the Commission Regulation (EU) No. 2022/720 (the block exemption regulation for vertical agreements). Suppliers should not restrict the buyer's ability to determine the sale price, without prejudice to the possibility of the supplier imposing a maximum sale price or recommending a sale price, provided that this does not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties.

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However, in the case of a commercial agency agreement, the principal may determine the resale prices (considering that the agent contracts in the name and on behalf of the principal).

The prohibition on determining (minimum) prices is enforced by the competition authorities (national and EU).

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?

Determining (minimum) prices is a hardcore restriction under the Commission Regulation (EU) No. 2022/720 (the block exemption regulation for vertical agreements). Suppliers should not restrict the buyer's ability to determine its sale price, without prejudice to the possibility of the supplier imposing a maximum sale price or recommending a sale price, provided that this does not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties.

The presumption of incompatibility of imposed resale prices extends to indirect price-fixing mechanisms, such as clauses making the granting of rebates or refunds subject to compliance with a recommended price level, clauses fixing the distributor's margin, etc. Arguably, a refusal to deal with customers who do not follow a pricing policy will result in indirect price-fixing and thus be prohibited. Also, imposing a minimum advertised price that prohibits a buyer from advertising a price below a level set by the supplier will be considered a form of determining minimum prices.

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 distribution agreement may include a clause that stipulates that the price offered to a distributor is no higher than the lowest price offered to other distributors.

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?

A seller may in principle charge different prices to different customers if it does not act contrary to competition law (eg, if it does not constitute an abuse of a dominant position), consumer law or other specific provisions that might apply (depending on the circumstances).

However, it is recommended to justify price differentiation with objective reasons to avoid accusations (and possibly even litigation) of discrimination, abuse of rights, etc.

Moreover, there may not be an abuse of economic dependence. This occurs when a seller applies different conditions to equivalent services with respect to economic partners, thereby placing them at a disadvantage in competition.

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?

In general, the restriction of the territory into which or of the customers to whom a distributor may sell the contract goods or services is prohibited. Such restrictions, both through direct obligations or through indirect measures (eg, refusal to grant rebates or refunds, refusal to deliver, etc) are presumed to infringe competition law (and constitute hardcore restrictions).

However, Commission Regulation (EU) No. 2022/720 (the block exemption regulation for vertical agreements) provides for certain exceptions to said presumption.

In particular, the restriction of active sales (as opposed to passive sales) into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer is allowed. Moreover, suppliers can also require direct buyers to restrict their own direct customers from actively selling into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer. Active selling means actively prospecting customers located within the exclusive territory or belonging to the exclusive customer group of another distributor. Consequently, passive sales (in response to unsolicited requests from customers) may not be restricted. The restriction of internet sales, which are perceived as passive, is therefore also prohibited.

Moreover, the restriction of (active and passive) sales to end users by a distributor operating at the wholesale level of trade is allowed. This allows a supplier to keep the wholesale and retail levels of trade separate.

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

The prohibition of geographic and customer restrictions is generally enforced by the relevant (national and EU) competition authorities, but private legal action (with an aim to obtain damages) is also possible.

Online sales

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

In general, the restriction of the territory into which or of the customers to whom a distributor may sell the contract goods or services, is prohibited. Such restrictions, both through direct obligations or through indirect measures (eg, refusal to grant rebates or refunds, refusal to deliver, etc) are presumed to infringe competition law (and constitute hardcore restrictions).

The Commission Regulation (EU) No. 2022/720 (the block exemption regulation for vertical agreements) provides for certain exceptions to said presumption.

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In particular, the restriction of active sales into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer is allowed where such a restriction does not limit sales by the customers of the buyer. However, passive sales (sales in response to unsolicited requests from customers, such as, in particular, internet sales) may not be restricted.

The restriction of active and passive sales (ie, including internet sales) to end users by a distributor operating at the wholesale level of trade is, however, allowed. This allows a supplier to keep the wholesale and retail levels of trade separate.

The Commission Regulation (EU) No. 2022/720 (the block exemption regulation for vertical agreements) provides that agreements that have the object of preventing the effective use of the internet to sell goods or services and is considered a hardcore restriction. However, this does not exclude the possibility for the supplier to impose on the buyer other restrictions of online sales or online advertising that do not have the object of preventing the use of an entire online channel. For example, restrictions that are linked to the content of online advertising or set certain quality standards are allowed (Guidelines on Vertical Restraints, 207, 210). In any event, a buyer should always be allowed to operate its own online store and to advertise online (Guidelines on Vertical Restraints, 208).

Moreover, note that the European Court of Justice has ruled that competition law does not preclude a contractual clause

> *which prohibits authorised distributors in a selective distribution system for luxury goods designed, primarily, to preserve the luxury image of those goods from using, in a discernible manner, third-party platforms for the internet sale of the contract goods, on condition that that clause has the objective of preserving the luxury image of those goods, that it is laid down uniformly and not applied in a discriminatory fashion, and that it is proportionate in the light of the objective pursued (ECJ 6 December 2017, C-230/16, ECLI:EU:C:2017:941).*

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?

In the Guidelines on Vertical Restraints, issued by the European Commission, the latter states that restrictions of the supplier's sales are not a hardcore restriction, as articles 4(b) and 4(c) of the Commission Regulation (EU) No. 2022/720 (the block exemption regulation for vertical agreements) only concerns restrictions of sales by the buyer (distributor) or its customers. Hence, arguably, the distributor may require reports and the payment of invasion fees or similar amounts.

However, note that article 4(f) of the Commission Regulation (EU) No. 2022/720 (the block exemption regulation for vertical agreements) prohibits the restriction, agreed between a supplier of components and a buyer who incorporates those components, of the supplier's ability to sell the components as spare parts to end users or to repairers or other service providers not entrusted by the buyer with the repair or servicing of its goods. Consequently, an agreement between a manufacturer of spare parts and a distributor who incorporates

these parts into its own products, may not, either directly or indirectly, prevent or restrict sales by the manufacturer of these spare parts to end users, independent repairers or service providers.

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 should be careful when it refuses to deal with particular customers, as such action could be contrary to competition law (eg, if it constitutes a restrictive practice or an abuse of a dominant position) or could be qualified as an abuse of rights (ie, an abuse of the freedom to contract).

Moreover, new legislation regarding the abuse of economic dependence has recently come into effect in Belgium. The new provisions explicitly state that there may be an abuse of economic dependence in the event of a refusal of a sale, purchase or other transaction.

Consequently, we recommend that suppliers justify every refusal to deal with objective reasons to avoid accusations (and possibly even litigation) of discrimination, abuse of rights, etc.

Under the Commission Regulation (EU) No. 2022/720 (the block exemption regulation for vertical agreements), a supplier may prohibit:

- active sales into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer where such a restriction can be passed on to the direct customers of the buyer;
- sales to end users by a buyer operating at the wholesale level of trade;
- sales by the members of a selective distribution system to unauthorised distributors within the territory reserved by the supplier to operate that system; and
- the buyer's ability to sell components, supplied for the purposes of incorporation, to customers who would use them to manufacture the same type of goods as those produced by the supplier.

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?

A distribution or agency agreement could be a reportable transaction under Belgian law if it leads to a lasting change of control resulting, in particular, from:

- the merger of two or more previously independent undertakings or parts of such undertakings;

- the acquisition, by one or more persons already controlling at least one undertaking or by one or more undertakings, of direct or indirect control over one or more other undertakings or parts thereof; or
- the creation of a joint venture performing all the functions of an autonomous economic entity on a lasting basis.

However, note that such a distribution or agency agreement will only be considered a reportable transaction if certain thresholds (ie, certain turnover thresholds of the undertakings concerned) are met.

Authorities will generally check whether the transaction could harm the functioning of the market (ie, competition), for example, by creating or strengthening a dominant position (however, any significant impediment to effective competition below the threshold of dominance can lead to a decision of incompatibility).

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 general principles of competition law (which are widely known), new legislation regarding the abuse of economic dependence has recently come into effect in Belgium.

In general, competition law (including the abuse of economic dependence) is enforced by national and EU competition authorities.

However, Title 3 'Action for damages for breach of competition law' in Book XVII of the Belgian Code on Economic Law enables natural or legal persons who have been harmed by a breach of competition law to claim damages before the Belgian courts.

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?

In general, distributors should make sure to address the parallel or 'grey market' import issues that might arise (eg, other companies not respecting the prohibitions with regard to active sales in certain territories or towards certain customers) to the supplier, instructing the latter to tackle such issues. If the supplier refuses to tackle the issue or does not assist the distributor, the latter could consider litigation. To obtain a strong position in (possible) litigation, we recommend the distributor to explicitly stipulate the supplier's obligations (to tackle certain issues or to assist in the case of certain issues) in the contract.

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 general, suppliers and distributors may advertise and market the products they sell as long as these advertisements respect the advertisement legislation. A supplier may also pass all or part of the advertising costs to its distribution partners. However, in the case of commercial agency such an obligation must be part of the precontractual information made available to the agent.

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 can safeguard their intellectual property rights by filing for registrations for patents, trademarks and designs. Other intellectual property rights do not require registration, but still benefit from protection. These are copyright and trade secrets.

When communicating or letting distributors use intellectual property rights, distributors should include licence agreements (technology transfer agreements) to the distribution agreements that grant the distributors the right to use the different intellectual property rights of the supplier without the ownership being transferred. Such a licensing agreement can also include the obligation for the distributor to notify third-party infringements of the supplier's intellectual property rights. Furthermore, such a licence agreement can contain a clause that provides that intellectual property rights developed by the supplier in the context of the distribution relationship will be transferred to the supplier and that the distributor will provide assistance with such a transfer and the potential registration.

Consumer protection

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

The supplier and distributor must take into account Book VI of the Code of Economic Law and articles 1649-bis to 1649-octies of the old Civil Code on consumer protection. Note though that the section of the Civil Code regarding consumer protection is currently under revision and will be part of the new Book 5 of the Civil Code.

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?

Manufacturers or suppliers must only bring safe products and services to the market (article IX.2 Code of Economic Law). If a product or service contains a risk for a consumer, then the supplier must notify the Belgian authorities of this risk. The severity of the risk is not relevant for this notification obligation. This can be done through the Product Safety Business Alert Gateway, which has the advantage that notifications can be made to multiple member states at once.

Parties may allocate the costs for a recall in their agreement. However, both the distributor and the supplier are responsible for notifying the authorities when they know or should know that a product or service is not safe (article IX.8, section 4 Code of Economic Law). Parties may allocate the responsibility of this notification obligation and we recommend that the party that notices the risk first must notify the authorities and provide the other party with a copy of that notification.

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 not completely limit its warranties towards distributors as this would hollow out the distribution agreement and would thus be presumed to be an abusive prohibited clause (article VI.91/5, section 3 Code of Economic Law). This does not mean that the supplier may exclude its warranty obligation partially.

Under Belgian consumer law, the seller of a product is held to the legal warranty of two years. Thus, the distributor selling to consumers will be held to respect the legal warranty.

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 distribution partners about the customers and end users when these data are personal data. In that case, the General Data Protection Regulation and the Belgian implementing laws are applicable, which means that the processing of these data must be fair, lawful and transparent (article 5 GDPR). It is important to note that personal data are owned by the data subjects (the natural persons they relate to) and thus are not owned by the distributor or the supplier.

Transfer of these data to third countries, which are countries that are not part of the European Economic Area, is subject to additional safeguards, as the GDPR or similar legislation does not apply there. In that case, additional contractual safeguards may be necessary. We recommend consulting experts if a supplier or distributor wishes to transfer personal data outside of the EEA.

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

Suppliers and customers must protect the security of customer data by taking appropriate technical and organisational measures (articles 24 and 32 GDPR). The extent of these measures depends on the context, the nature of these data, the scope of processing etc. Note that one of the main principles of the GDPR is accountability. It is thus important that the distributor or supplier can demonstrate that it took and is taking the necessary measures (article 5.2 GDPR).

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?

As the employment agreements and management agreements are concluded between the distributor and its personnel, the supplier cannot end the agreement. However, it could be included in the distribution agreement that the supplier has a say in the personnel of the distributor. Such key-person clauses are often used in practice.

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?

If it appears that the supplier has factual authority over an agent or a distributor and the latter two are in a subordinate position towards the supplier, the distribution relationship may be requalified to an employment agreement, which means that the supplier is considered to be the employer of that distributor or agent. This entails that the supplier is responsible for respecting Belgian labour law and must pay the salary, social security, taxes, etc of the employees retroactively. These costs risk being quite high, but the supplier may also be subject to administrative and criminal fines.

The supplier must thus make sure not to exercise too much control over how a distributor or agent organises its activities. Moreover, the distribution agreement could contain clauses relating to the respect of labour laws.

Commission payments

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

A commercial agent must be compensated for its intermediation for the principal, but parties can freely decide on the type of compensation. Usually, the negotiation of sales is made in exchange for a commission, but it is also possible to agree to a fixed remuneration or a combination of both fixed and variable remuneration. In that regard there is very recent case law of the court of appeal of Ghent confirming that the compensation should not necessarily be linked to the negotiation itself.

Good faith and fair dealing

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

The Belgian Civil Code contains an obligation for parties to perform agreements in good faith (articles 5.69 and 5.70 Civil Code). Moreover, Book VI of the Code of Economic Law contains more provisions applicable to agreements concluded after December 2020.

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?

The supplier or the distributor can only invoke its trademark or patent licence against third parties if it has been registered in the relevant register. More concretely, a copy of the licensing agreement signed by both parties or an extract thereof must be submitted. A trademark licence must be registered with the Benelux Office for Intellectual Property and a patent licence must be registered with the Service of Intellectual Property of the FPS Economy.

A distribution agreement does not need to be registered or approved by any Belgian government agency.

Anti-corruption rules

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

Suppliers and their distribution partners must respect the anti-bribery and anti-corruption laws of the Belgian Criminal Code.

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 mandatory law provisions applicable to commercial agency agreements and exclusive distribution agreements do not need to be included in the distribution agreement to apply to the parties' relationship, such as provisions relating to precontractual information, termination and indemnities. Moreover, Book VI of the Code of Economic Law contains stipulations on contract clauses that are prohibited or presumed to be prohibited when they are abusive.

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?

Belgian law provides for a high level of protection of distributors in the event of unilateral termination of an exclusive or quasi-exclusive distributorship concluded for an indefinite duration.

The legal protection is established by Title 3, Book X of the Code of Economic Law, titled 'Unilateral termination of exclusive distribution agreement of indefinite duration'. These provisions are qualified as overriding mandatory law (*loi de police*) but not as public order law and therefore not as international public order law.

A distributor engaged in a distributorship having effect in all or part of Belgium may always submit its claim to the Belgian courts and the latter are obliged to apply the Distribution Law or Title 3, Book X of the Code of Economic Law to a distributorship agreement, notwithstanding any clause to the contrary (article X.39 of the Code of Economic Law or article 4 of the former Distribution Act) (article 9.2. Rome I Regulation).

The only way to escape the implementation of the mandatory provisions of Title 3, Book X of the Code of Economic law to the termination of the agreement having effect in all or part of Belgium is to provide for a jurisdiction clause according to Regulation (CE) No. 44/2001 or Regulation (CE) No. 1215/2012, providing for the jurisdiction of other courts than the Belgian ones. There is established case law acknowledging the jurisdiction of the foreign EU court if the jurisdiction clause is valid on the basis of the above Regulations. In the absence of such a jurisdiction clause, the Belgian judge will be obliged to declare itself with jurisdiction and to apply the mandatory provisions of Title 3, Book X of the Code of Economic Law or of the Distribution Law.

It should be noted that this method of avoiding the application of Belgian law does not work regarding an issue in the precontractual phase, as the agreement cannot be considered as concluded yet. Therefore, whenever possible, it is advisable to provide in the receipt of

acknowledgement of the PID a jurisdiction clause like the one contained in the distribution agreement itself.

On the basis of the Rome I Regulation and more particularly article 9.3 of such Regulation, the distributor could try to argue that the rules in Title 3, Book X of the Code of Economic law are overriding mandatory law and must be applied by the foreign judge, but the latter is usually reluctant to do so when the parties have chosen the law of his or her state to rule over the relationship. In addition, this argument could also be challenged on the basis of the fact that the rules in Title 3, Book X of the Code of Economic law only concern the termination of the distribution agreement and are not such as to render the performance of the agreement unlawful (ie, the situation provided in article 9.3 of the Rome I Regulation).

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 include a jurisdiction clause in the distribution agreement. However, several decisions of the Supreme Court have found that an arbitration clause in an exclusive distribution agreement of an indefinite term is not enforceable.

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 Belgian Commercial Courts have jurisdiction over disputes between companies. Moreover, the parties can appeal the decisions taken by the latter before the Court of Appeal. It should be noted that the Belgian judiciary system is underfinanced, which results in very long procedure times, especially in the case of an appeal, where this can amount to a period of 10 years. Thus, the option of settling or alternative dispute resolutions can be interesting.

There are no restrictions on making use of courts and procedures for foreign businesses. As Belgium is part of the Council of Europe, parties can expect a fair trial under article 6 of the ECHR.

A litigant can require the opposing party to disclose documents. It is important to note that if that information is confidential, then the disclosing party can require the confidentiality of these documents under the new trade secrets legislation.

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?

An agreement to mediate or arbitrate will generally be enforced in Belgium. Lawyers are even obliged to propose to their clients to settle the dispute amicably before turning to judicial procedures. Note, however, that arbitration clauses will not be enforceable in exclusive distribution agreements.

The advantage of arbitration is that parties can choose the arbitrators, and these can have technical skills in a specific sector. Arbitration will also be much faster and can be confidential. However, arbitration is known to be very expensive.

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 Civil Code is currently still under review and is being transformed in an instrument consisting of different books, such as the Code of Economic Law. This revision is not limited to a formal revision as the content is also being reviewed. The Civil Code does not contain specific provisions relating to distributorship, but it does contain general contract law.

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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.

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 the sole owner of a local company (affiliated company). For the creation of a local company with a foreign shareholder, the company must have its headquarters in the territory and have 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.

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 partner 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 for a company with regard to 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.

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, 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.

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.

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, for example, are authorised after complying with the recordation of the corresponding agreement at the Brazilian National Institute of Industrial Property. 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.

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, 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.

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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.

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 need 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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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 case the 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.

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 or 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.

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.

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).

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.

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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.

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.

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.

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.

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.

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.

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.

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.

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.

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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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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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.

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.

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 out 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 out 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.

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 2021 was equal to an enterprise value of C$1.043 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.

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 out 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
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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.

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.

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 (namely, Ontario, British Columbia, Alberta, Prince Edward Island, New Brunswick and Manitoba) have enacted 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.

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.

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.

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.

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.

However, in Quebec, if the contract does not provide whether an assignment or transfer may occur without the other party's consent, their consent would generally be required.

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.

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.

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.

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.

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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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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, recent case law demonstrates that, 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.

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.

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.

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.

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.

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.

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 recent 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 recent *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 a bill to replace PIPEDA with the Consumer Privacy Protection Act 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. Under Quebec law, persons who collect personal information must refrain from transferring this information to jurisdictions where it would not be afforded the same protections as those required under Quebec privacy law. The province of Quebec has also recently enacted amendments to Quebec's provincial privacy regime, which will be coming into force gradually during 2022 and 2023. These changes strengthen enforcement by imposing the mandatory appointment of internal privacy officers, and by implementing new breach reporting requirements and 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, although draft federal legislation that would amend PIPEDA to further strengthen privacy measures and enhance consumer privacy protections is currently winding its way through the legislative process.

The parties to a distribution or agency agreement may determine who 'owns' the information collected from customers and end users (although Canadian privacy law does not consider that data 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.

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 its 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 its own purposes.

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.

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.

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.

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.

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.

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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.

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.

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 by federal or provincial law on certain industries viewed as having particular importance or significance (eg, 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), and 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.

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.

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.

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 may elect to submit to the courts or arbitration tribunals of any jurisdiction, subject to the certain limitations. 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 policy 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.

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.

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 businesses may be subject to different mandatory costs than would domestic businesses.

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.

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.

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?

Following recently enacted amendments to the Alberta Business Corporations Act and the Ontario Business Corporations Act, the provinces of Alberta and Ontario have respectively repealed the long-standing obligation requiring that a certain percentage of directors of corporations incorporated pursuant to the corporate statutes of such provinces, be Canadian residents. Accordingly, all of the directors of a corporation constituted under the corporate statute of Alberta or Ontario may be non-residents of Canada.

These modifications align these provinces' corporate governance regimes with the regimes already in place in many other Canadian provinces including Quebec, British Columbia, Nova Scotia and New Brunswick.

In light of the foregoing, foreign suppliers wishing to conduct business in Canada may take comfort in the fact that a growing number of Canadian provinces are opting for flexibility in allowing the incorporation of provincial Canadian subsidiaries governed entirely by foreign directors. Foreign investors wishing to establish businesses in several provinces will also be less constrained in their choices in such respect. It is, however, important to remember that certain provinces, such as Manitoba and Saskatchewan, still maintain certain director residency requirements for corporations.

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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 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, such as gene diagnosis and therapy and military products, and local importers and distributors have to be engaged to import these products.

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.

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.

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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 Special Administrative Measures (Negative List) for the Access of Foreign Investment (the Negative List) 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 is subject to changes by the government from time to time.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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 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 to monopolise the market are generally prohibited, unless the parties can prove that the price-fixing arrangements or price maintenance conduct do not give rise to anti-competitive effects under the Anti-Monopoly Law (2022 Amendment).

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.

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.

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.

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.

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.

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.

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.

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.

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 share-holdings 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.

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.

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.

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.

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).

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.

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.

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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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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 the local court and the court proceeds with the case, it is unlikely that the local court will apply the governing law as set out in the distribution contract. Instead, Chinese laws are likely to be applied.

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.

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 is 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, evidence outside China should be legalised or authenticated by a Chinese embassy or consulate, and special attention should be paid at the preparation stage).

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 are generally enforced, and 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. The second and third institutions were formerly subcommissions of the CIETAC, in Shanghai and Shenzhen respectively. As both are now independent, an arbitration clause previously designating them as CIETAC subcommissions should be revised, otherwise there may be an issue regarding the identity of the institution.

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.

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 accordance with the revised Foreign Trade Law effective from 30 December 2022, authorities in China no longer require entities applying for certain certificates and qualifications (eg, import and export licenses, technology import and export contract registration certificates or quotas) to provide foreign trade operator filing and registration records. Accordingly, entities may apply to local authorities for the relevant certificates and qualifications directly without recordal as a foreign trade operator.

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DIRECT DISTRIBUTION

Ownership structures

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

Yes. Whether from the European Economic Area or not, inward investments are welcome.

In general, there are no restrictions in respect of title to, and ownership of, shares or business assets. However, should a person be in an extremely narrow business sector that is perceived as putting at risk an important national interest, such as in the business of banned dual-use goods export, that person would be well advised, under the Monitoring Act (1612/1992), to seek formal permission from the Ministry of Employment and Economy.

Any business established and registered under Finnish law is regarded as Finnish irrespective of ownership. However, the registration and running of a branch of a foreign entity from outside the European Economic Area require the consent of the Trade Register, operated by the Finnish Patent and Registration Office. Generally, consent is readily granted.

Depending on how detailed and extensive the by-laws (articles of association) are, the estimated cost of setting up a company will vary between about €1,000 and €10,000, including the fixed registration fee and a tax account for the purpose of income tax, VAT and employer liabilities.

The above notwithstanding, for persons from elsewhere than the European Union or the European Economic Area who intend to contribute personally by working in Finland, the migration laws generally pose quite a hurdle. So does the opening of a bank account in Finland should the company wish to have an account with a Finnish bank (eg, for the purpose of substantiating payment of the initial contribution – that is, the subscription price for the shares, generally equal to the share capital to be registered). Of course, this is because of the overly strict adherence by Finnish banks to the EU rules for combatting money laundering. Therefore, businesses from within the EU are well advised to have an account established in the name of the company through a bank in their own country.

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

There are no quota limitations for foreign participation.

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 private limited liability company is by far the best suited. It can be formed by one person, whether physical or juridical. Mainly, all that is needed is to adopt the by-laws containing,

at a minimum, the company name, domicile and field of operations, sign the memorandum of association that rarely fills more than one sheet of paper and file the notification with the Trade Register. However, a person must be careful not to encroach upon anyone else's trade name or trademark, and be able to bring forth evidence to the effect that the subscribed number of shares has been fully paid for in advance to a bank account within the European Union, this being, additionally, confirmed by a chartered accountant. Furthermore, all the directors must be registered.

In principle, the Companies Act (624/2006), and for the incorporation procedure the Trade Register Act (129/1979) and Ordinance (208/1979), govern business entities.

Restrictions

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

In general, the foreigner-specific restrictions in respect of operating are limited to foreigners from outside the European Economic Area and concern mainly the fields of defence, banking, financing and insurance. Although most direct obstacles to foreign investment have been abolished, Finland, like most other EU member states, has retained some restrictions that mainly relate to investment from outside the European Union or the Organisation for Economic Co-operation and Development. The most important national laws restricting or prescribing conditions for foreign investment are the Act on Monitoring of Foreigners' Corporate Acquisitions (1612/1992) and the Act on Freedom of Trade (122/1919). Accordingly, a business operating in a narrow business sector that is perceived as putting at risk an important national interest, such as in the business of dual-use goods requiring a licence for export, is obliged under the Monitoring Act to seek formal permission from the Ministry of Employment and Economy. Generally, consent has been readily granted. However, at present, the EU sanctions against Russia and its allies have made this more difficult, particularly within the banking, financial, defence, aviation, shipbuilding and machinery sectors.

If the foreign business runs a Finnish subsidiary, at least one of the directors, including the managing director (eg, CEO or president), must be a resident of the European Economic Area, unless the Trade Register grants an exemption. The auditor should be a resident authorised or approved public accountant. If there is no person within the European Economic Area entitled to sign in the name of the subsidiary or the branch, there must be a registered agent for service of process in Finland.

Equity interests

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

There are generally no restrictions in respect of title to shares or business assets. However, a business operating in a narrow business sector that is perceived as putting at risk an important national interest, such as in the business of dual-use goods requiring a licence

for export, is obliged under the Monitoring Act (1612/1992) to seek formal permission from the Ministry of Employment and Economy. Normally, consent is readily granted.

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?

In general, foreign businesses are taxed on income sourced in Finland only. On the formation of an importer owned by a foreign supplier, no tax is levied, just a modest handling fee.

Should the foreign business have a permanent establishment (PE) in Finland, it will be liable to tax on all income attributable to the PE. Moreover, depending on its domicile and the kind and origin of the products imported, the foreign supplier may also be subject to customs duties. In addition, with regard to its imports, the supplier may be subject to car purchase tax and excise duties levied on, for example, tobacco, alcoholic beverages, soft drinks and liquid fuels.

Given that a foreign business is taxed only on income sourced in Finland and that it will be liable to tax on all income attributable to the PE, sales revenue, interest, royalties and capital gains are included, but costs, expenses and losses attributable to the business are deductible. If a PE's business operation results in a loss, the loss will be deductible over the subsequent 10 tax years, applying the same loss carry-forward rules that are applied in respect of Finnish business entities. However, these rules will not apply should more than half the ownership of the company change hands.

Dividends are generally totally tax-exempt both domestically and under the EU Parent-Subsidiary Directive, subject to the 10 per cent minimum shareholding requirement, or tax-exempt on a quarter, subject to the double tax treaty between Finland and the country from which the dividends are distributed. The corporate tax rate is 20 per cent. As there are currently no thin capitalisation restrictions, a business can be financed from abroad; however, this is subject to some rather intricate rules on the deductibility of interests paid in excess of €500,000.

Generally, the tax treaties provide for tax on dividends and royalties varying between 5 and 15 per cent to be withheld at source. However, where the EU Parent-Subsidiary Directive is applicable, no withholding tax is levied on profit distribution, such as dividends, to a parent company holding, directly, at least 10 per cent of the equity of the profit-distributing company. Where the Directive is not applicable, the withholding tax at source on dividends is 15 per cent.

For other non-resident corporate bodies, generally the rate of withholding is 20 per cent on profit distribution, interest (where not completely tax-exempt) and royalties. For physical persons, the rate is 35 per cent on income from employment, pensions and distributions by employee investment funds, unless otherwise agreed in the tax treaty concluded with the recipient's country of residence. With the exception of the above-mentioned, most of the income of non-residents derived from Finland is taxed on an assessment basis.

From the viewpoint of a foreign business electing to use a limited liability company as its vehicle, it is notable that merely in the field of income tax for the purpose of avoidance of double taxation and tax evasion, Finland has concluded 77 treaties in force, some of which are multilateral and take precedence over domestic tax law. The most frequent method for eliminating double taxation is the ordinary credit method.

Where there is no double tax treaty with the domicile state of the foreign taxpayer, the country's tax rights will be determined by domestic tax laws.

Non-Finnish residents are taxed in Finland on income sourced in the country, subject to any applicable treaties for the avoidance of double taxation. Under certain conditions and subject to the approval of an application, salary earners with special expertise may, for a maximum period of four years, be entitled to participate in a regime permitting the employer to withhold, in lieu of income and municipality tax, 35 per cent of the salary earned. Otherwise, alien employees will be liable for progressive tax on their salary or wages should they stay in Finland longer than six months, regardless of citizenship. If the stay lasts no longer than six months, the Finnish employer will collect a 35 per cent tax at source on the pay and withhold social security payments unless the pay is effectuated by and encumbers a foreign company. Royalties paid to holders of intellectual property rights who are not Finnish residents are subject to a 28 per cent tax at source. The tax rate is 30 per cent for capital income and 34 per cent where capital income exceeds €30,000.

In general, goods and services supplied in Finland during the course of business are subject to VAT. Although the general rate of VAT is currently 24 per cent, the rate for food and restaurant and catering services is 14 per cent, and the rate for categories such as books, subscribed newspapers, cultural events, medicines, fitness services, passenger transport and accommodation is 10 per cent.

Real estate tax is assessed on the taxable value of the property, whether it be land or buildings. Transfer of title to shares of a private limited liability company is generally subject to a transfer tax of 1.6 per cent of the price agreed. On transfer of real estate, the tax rate is 4 per cent.

LOCAL DISTRIBUTORS AND COMMERCIAL AGENTS

Distribution relationships

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

For both newcomers and established suppliers, commercial agencies provide a means of penetrating and exploiting the market as well as launching a selection of new products. For the supply of heavy capital equipment (eg, industrial machinery), agents, whether commercial or undisclosed commission agents and with or without a consignment stock, are useful. However, often the best suited for products requiring local storage or modification is the variety of available open or closed distributorship arrangements, such as dealers, value-added resellers and selective distributors, the latter being favoured by high-tech as well as luxury products manufacturers.

It is remarkable that within the sphere of grocery, which in Finland is worth more than €20.2 billion, in 2020, 82.9 per cent of the market was divided between just two major wholesale groups (the S-group and the K-group, Kesko), each with their retail supermarkets and stores, some of which are franchised. Each group controls a number of affiliated businesses, nationally and abroad, processing (under a great variety of store brands and other private labels) a considerable portion of their whole range of products. Some of the private label products emanate from small or medium-sized quality manufacturers who specialise in particular product lines and, as a parallel concept, take advantage of the opportunity to have their similar products, under brands of their own, frequently marketed within the retail stores of the aforementioned major wholesale and retail groups. Some of the private label products are also exported and distributed, through retailer outlets of the groups, to consumers in the Baltic countries, Russia and Poland. In addition, there is a third newcomer (Lidl), presently with a market share of about 9.2 per cent, with its own store brands covering about 75 per cent of its whole assortment of products, fiercely challenging the two main groups, in particular simply by offering lower prices. In many cases, for newcomers to the Finnish grocery market, a practical means may be to attempt to have the products launched through a sales channel offered by one of those three big operators. Under these circumstances, it is understandable that the concentrated grocery market poses a concern for the Competition and Consumer Authority.

Apart from business format franchise contracts, product distribution franchise contracts are a recognised mode of distribution of, in particular, daily consumer products regardless of whether the following apply:

- the franchisee also carries products of suppliers other than those of the franchisor;
- the trademark is established;
- the system feature of the franchisor is weak or strong; or
- services, such as training and continued assistance, are good or poor.

These (or similar) apply to a variety of trademark licensing arrangements. An optional manufacturing licence contract may warrant the local distributor the ability to manufacture the quantities demanded should the supplier no longer be able to meet the demand. In particular, in the latter case, the manufacturer or supplier may wish to participate, by means of shareholding, in the business of its distributor.

Similarly, as globally, e-commerce is a steadily growing phenomenon challenging both department and brick-and-mortar stores.

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 fairly narrow concept of commercial agency is regulated by the Act on Commercial Representatives and Salesmen (417/1992). The agent, denoted as a commercial representative in the statute, is defined as an entrepreneur who, in a representation contract concluded with another (the principal), has undertaken to continuously promote the sale or purchase

of goods on behalf of the principal by obtaining offers for the principal or by concluding sales or purchase contracts in the name of the principal.

There are other types of agents outside the purview of the Act, such as concealed agents and consignment or commission agents, as well as any kind of agency for the supply of services.

The relationship between a supplier and its distributors of goods or services is not regulated by any particular statute but by a number of more or less general statutes, such as the Contracts Act (228/1929), the Sale of Goods Act (355/1987), the Act on Payment Terms of Commercial Contracts (2013/30), the Act on Adjustment of Contract Terms between Entrepreneurs (1993/1062) and the Unfair Business Practices Act (1061/1978). Of particular importance are the EU competition rules and, often, the new Trade Secrecy Act (595/2018). For businesses within the agricultural and foodstuff chain, there are specific stipulations contained in the Act on Marketing Agricultural Products and Food Stuff (1121/2018).

The Competition and Consumer Authority is the government agency that exerts certain powers in respect of competition but is generally regarded as lacking the means to effectively have an impact on consumer issues.

There are a host of self-regulatory constraints and guides that govern the distribution relationship, such as those published under the auspices of the International Chamber of Commerce (ICC). One of the most prominent is the translation into Finnish of the Consolidated ICC Code of Advertising and Marketing Communication Practice 2011. In addition, there are a number of guidelines for advertising and marketing. Moreover, there are the Council of Ethics in Advertising and the Board of Business Practice, both of which are subagencies of the Finland Chamber of Commerce and specialise in business-to-business sales and marketing issues. In particular, the opinions of these two bodies are held in high esteem for convincing courts and arbitral tribunals on ethical advertising and fair business practice.

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?

No, freedom of contract prevails, in general. Apart from where the contract is made for a certain duration, the prevailing opinion is that a party to a distribution relationship cannot be forced to be bound perpetually, and accordingly, unless the parties contractually agree otherwise, both parties are deemed to be allowed to terminate the contract without any specific cause. The aforementioned notwithstanding, there should be a certain time period within which the contracting party may adapt smoothly to the change in circumstances; therefore, the length of the period of notice may vary for a number of reasons.

Any clause that allows the contract term to be renewed must provide for accommodating the change in circumstances.

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

Except where the relationship is qualified as that of commercial agency, no mandatory/statutory compensation or indemnification is due to the distributor, commission agent or self-employed intermediary solely for the reason that the contract was terminated without cause. However, where essential properties of the relationship are similar to those of a commercial agent, case law suggests that the courts may be inclined to make use, analogously, of the provisions of the Act on Commercial Representatives and Salesmen (417/1992), harmonised with article 17, paragraph 2 of Directive 86/653/EEC (Council Directive of 18 December 1986 on the coordination of the laws of the member states relating to self-employed commercial agents). Case law is very rare, but there are a few cases implicating the possibility of analogous application should the distributor have been involved in the sales structure similarly to a commercial agent who is under the duty of handing over customer information to the principal. (The implications of this analogous application can be found in Supreme Court case KKO 1987:42.) Where the relationship is terminated without acknowledging the need to provide a period of notice to enable the opposite party to accommodate itself to the change in circumstances, the intermediary should be able to count on being compensated for the loss caused. The same is true where the termination can be demonstrated as being abusive.

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?

Based on the principle of freedom of contract, yes. However, the general rule of the Contracts Act, admitting the competent court to adjust a contract provision that is found to be unconscionable, has been applied in court practice on a number of occasions. The main thrust of the rule is that should the court deem a contract term to be unfair or the application of it to lead to an unfair result, the term may be adjusted or set aside (eg, under section 36 of the Contracts Act as amended by Law 956/1982, or the Act on Adjustment of Contract Terms between Entrepreneurs (1993/1062)). In particular, should the distributor or agent run the risk of going out of business because of a contract provision prohibiting him or her, at the peril of payment of damages, from transferring the ownership of his or her business, for a lengthier period of time and with no regard to the change of circumstances, the court may determine the provision to be grossly unfair, unreasonable or otherwise unconscionable.

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?

No, in principle, there are none. However, in respect of, for example, exaggerated confidentiality provisions by which a contract can become frustrated, the general rule of the Contracts Act may be applied, admitting the competent court to adjust a contract provision that is found to be unconscionable.

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 imposed on the distributor for the period of the distribution agreement are enforceable in so far as such obligation either lasts for no longer than five years or the obligation is tacitly renewed beyond the period of five years, either as such or as part of the distribution agreement. However, in respect of non-compete obligations imposed on the distributor for the period after termination of the distribution agreement, the applicable competition laws leave, in practice, little room for such obligations (Commission Regulation (EU) No. 720/2022, article 5, on the application of article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices). The above notwithstanding, non-compete obligations of a distribution agreement can benefit from the de minimis rule; thus, where the supplier's market share does not exceed 15 per cent of any of the relevant markets affected by the distribution agreement, and the agreement, therefore, can be regarded as not appreciably restricting competition pursuant to the principles contained in the Commission Notice on Agreements of minor importance (OJ 2014, C 291/1), the non-compete clause would be enforceable.

Prices

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

Considered a restriction by object, resale price maintenance, price fixing or alike control imposed by the supplier, whether directly or indirectly, such as by determining the distributor's sales margin or maximum reductions to be granted to customers, is prohibited under article 101(1) of the Treaty on the Functioning of the European Union (TFEU) to categories of vertical agreements and concerted practices, without need to prove the actual effect of such control on the market. The same tends to pertain to any maximum price advertising agreement whereby the distributor agrees not to advertise prices below those recommended, although the distributor remains free to set lower prices. However, the supplier is allowed to impose maximum resale prices (eg, by prohibiting the distributor from exceeding certain prices) whereby the supplier may endeavour to prevent the distributor from misusing the exclusivity granted to him or her by means of fixing excessive prices. Moreover, recommended

resale prices are permitted subject to such practice not interfering with the distributor's freedom to set its own prices, but can be used by the distributor for granting discounts, for example. In addition, there should be no obstacle either for the practice of fixing different wholesale prices for products sold online and those sold offline (dual pricing). However, it is somewhat questionable whether it is permitted or not for suppliers to recommend in general terms pricing policy compatible with the image or value of the products sold by, for example, inviting the distributor to respect the image and value of its brands when determining the resale price.

As, in most cases, the commercial agent is integrated in the principal's sales network and is also otherwise a genuine agent, the agent remains outside the scope of the competition rules concerning price maintenance.

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?

Resale price recommendations and suggestions are permitted, but establishing a minimum advertised price policy may, depending on its contents, be branded as anticompetitive. However, this would not foreclose advertising recommended prices. Nevertheless, any defensive boycott to punish violations of agreements that restrain competition is a prohibited type of discrimination. The same is true of any predatory boycotts.

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?

There are no restrictions on including a most-favoured-customer clause in the contract.

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 should be no obstacle to applying different prices to different types of customers and in different locations or to granting different discount rates to individual customers and so on, provided that the criteria are not arbitrary or discriminatory, and are applied consistently.

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 supplier may prevent the distributor from actively selling to certain geographical areas or categories of customers if the latter are exclusively reserved for the distributor, agent or principal. The supplier may not prevent the distributor from selling passively (ie, sales that are not actively solicited). In the event of a selective distribution system, the rule expressly authorising the restriction of sales by the members of the system to unauthorised distributors within the territory reserved by the supplier to operate that system is applicable

(Commission Regulation (EU) No. 720/2022, article 4c, section iii on the application of article 101(3) of the TFEU to categories of vertical agreements and concerted practices).

Exclusive territories are permitted (in principle) and are customary.

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

The supplier may prevent the distributor and its direct customers from actively selling to certain geographical areas or customer groups reserved to the supplier or allocated by the supplier exclusively to a maximum of five exclusive distributors. The supplier may not prevent the distributor from selling passively (ie, sales that are not actively solicited). In the event of a selective distribution system, the rule expressly authorising the restriction of sales by the members of the system to unauthorised distributors within the territory reserved by the supplier to operate that system is applicable.

Prohibition is generally enforced by private legal action alone, unless it is enforced using available and appropriate measures by the Competition and Consumer Authority (eg, issuing a prohibition to implement a restraint on competition, issuing an order to terminate a restraint or obligating delivery, withdrawing a block exemption and initiating proceedings for penalty payment).

Online sales

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

Generally, no. However, the supplier may require that e-commerce sales meet certain qualitative criteria. The supplier may not restrict or prohibit passive reselling outside the distribution partner's assigned territory. However, restriction of active sales outside a distributor's assigned territory is permitted.

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?

This sort of contingency may come about in horizontal distribution arrangements or where the distributor has acquired a dominant position. As to whether an agent may restrict the supplier's sales through e-commerce intermediaries into the agent's territory, as far as we know there is no Finnish case law to draw on. However, as genuine agency implies sale by the principal, it is believed that those types of restrictions, seemingly to the disadvantage of the principal, are permissible. In respect of distributors and those agents, the agreements of whom fall within the framework of article 101 of the TFEU (ie, closed systems with absolute territorial protection granting the distributor protection against parallel imports), restrictions of e-commerce intermediaries into the distribution partner's territory are to be judged from an antitrust perspective. Provided that the agreement neither affects competition to any appreciable effect nor is considered to be grossly unfair, unreasonable or otherwise unconscionable, the distributor's restrictions on the supplier's sales through e-commerce intermediaries into the distributor's territory would be regarded as permissible. Conversely,

where the market share of the parties exceeds the 30 per cent threshold indicated in article 3(1) of the Block Exemption Regulation (720/2022), those restrictions are not block-exempt and their compliance with article 101 of the TFEU will have to be assessed.

Within the above framework and as the exchange of information between distribution partners is permissible subject to certain rules, including the EU General Data Protection Regulation (GDPR), both the distributor and the agent may require the supplier to obtain reports of sales through e-commerce intermediaries by territory and a payment of 'invasion fees' or similar amounts to the distribution partner.

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?

Unless it amounts to abuse of a dominant position or is deemed to be unfair business practice, refusal to deal with particular customers is, in general, part of the freedom of contract.

However, apart from preventing the distributor from conducting active sales in certain geographical areas or to certain categories of customer, within the framework of a selective distribution system, the supplier may restrict its distributor's ability to deal with unauthorised distributors outside the territory of the system (ie, non-members of the system). In addition, businesses in the agricultural and foodstuff chain should pay attention to specific stipulations on or which are equivalent to refusal to deal contained in section 2e of the Act on Marketing Agricultural Products and Food Stuff (1121/2018).

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 merger control rules, a distribution contract may, at least in principle, be deemed a reportable transaction if the supplier exploits market power in trading relationships with distributors to earn excessive profits or to gain other advantages. The contract may also require clearance if it amounts to the supplier exerting exclusionary or predatory abuses, such as the imposition of unfair selling prices or conditions that do not fall within the sphere of the vertical restraints generally applied to distribution contracts. These practices eventually result in concentrations and cause conditions for competition to deteriorate, which may be dangerous in a small market, such as the Finnish market. Under merger control rules, a distribution contract is a reportable transaction requiring clearance by the competition authorities where the combined turnover of the parties exceeds €350 million, and the Finnish turnover of at least two of the parties exceeds €20 million each.

The standard used for evaluating the transaction in terms of the calculation of turnover is the government decree on the calculation of turnover of parties to the concentration (1011/2011) and the standards and practices described in the Guidelines on Merger Control

issued by the Competition and Consumer Authority (FCCA). If the concentration falls within the scope of Council Regulation (EC) No. 139/2004 on the control of concentrations between undertakings, the acquisition shall be notified to the European Commission, which has the sole right to examine the concentrations with a Community dimension.

Unless it is about an untrue or a non-genuine agency agreement, the agent as an auxiliary of his or her principal remains outside the scope of the antitrust rules.

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?

Although single branding is frequently implemented by means of a non-competition clause, it can also occur otherwise and be objectionable without a five-year or one-year grace period. This is the case if competitors are excluded from the market. Tying arrangements may affect the market for those manufacturing the relevant products as well as the price of the products. In addition to the prohibitions against anticompetitive agreements, there is the prohibition against abuse of dominance that constrains the relationship between suppliers and their distribution partners.

Suppliers and their distribution partners must comply with section 5 of the Competition Act (948/2011) and articles 101 and 102 of the TFEU. The competent agency to enforce such laws is the FCCA.

Private parties can bring actions under antitrust or competition laws. Liability in damages under section 20 of the Competition Act is due to anyone who has suffered damage or loss because of infringement of sections 5 or 7 of the Competition Act, or articles 101 or 102 of the TFEU.

The available remedies include damages for economic loss, whether direct or indirect, such as, but not limited to, expenses, price difference and lost profit. Any losses because of price discrimination, excessive pricing due to a cartel or the refusal by a party in a dominant position to supply are deemed as direct losses to be compensated.

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?

No, except for selective distribution (Commission Regulation (EU) No. 330/2010, article 1(e) on the application of article 101(3) of the TFEU to categories of vertical agreements and concerted practices).

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?

The main provisions are contained in the Unfair Business Practice Act requiring truthfulness in connection with all sales and marketing, including advertising, and in the Consumer Protection Act (38/1978) regulating sale and marketing to consumers.

There is no statutory limit with regard to whether a supplier may pass all or part of its cost of advertising on to its distribution partners or share in its cost of advertising.

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?

Safeguarding of intellectual property rights (IPRs) is mainly implemented contractually and by means of registration. Any individual is entitled, on application, to a patent if he or she, or his or her successor in title, has made an invention susceptible of industrial application. Exclusive rights for a trademark may be acquired, even without registration, after the mark has become established. A trade symbol is considered established if it has become generally known in the appropriate business or consumer circles in Finland as a symbol specific to the goods or services of its proprietor. Any artistic or literary work, independently originated by a human being, and of original character, expressed in any manner or form, qualifies for copyright. In respect of software and databases, sheer originality is enough. As long as this requirement is fulfilled, copyright arises by virtue of itself. Only copyright, know-how and trade secrets can be registered.

The supplier is encouraged to safeguard its IPRs by means of provisions to the effect that the distributor is under a duty to inform the supplier of infringement of its IPRs, to assist it in the defence of its rights and not to reveal, either during the currency of the contract or after its termination or expiry, the supplier's trade or commercial secrets or other confidential information, such as know-how and technical data, nor to use the secrets or confidential information for purposes other than those of the contract.

Technology transfer agreements are common.

Consumer protection

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

A number of laws and decrees supplement the Consumer Protection Act (38/1978), such as the Act on Provision of Information Society Services (458/2002) and the Communications Market Act (393/2003), both of which aim to ensure reasonably priced communication services for consumers. In addition, there is the Consumer Safety Act (920/2011), the Act on the Safety of

Toys (1154/2011) and the ancillary government decree, and the Decree on Certain Chemical Requirements for Toys (1352/2013). Moreover, there are government decrees on the data to be provided on consumer goods and services (613/2004), on price information on consumer products and services (553/2013) and concerning unfair business-to-consumer commercial practices (601/2008, implementing the EU Unfair Commercial Practices Directive 2005/29/EC), as well as:

- the Food Act (23/2006);
- the Accommodation and Nutrition Agency Act (308/2006);
- the Package Tour Agency Act (939/2008);
- the Act on the Provision of Services (implementing Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market, 1166/2009);
- the Insurance Contracts Act (543/1994); and
- the Act on Registering Debt Collectors (411/2018).

Generally applicable supplemental statutes are the Interest Act (633/1982) and the Penal Code (1889/39, as amended). The Penal Code includes chapters on business offences and on offences endangering health and safety (consumer credit offence (Chapter 30, section 3), charter trip company violation and charter trip company offence (Chapter 30, section 3a) and health offence (Chapter 44, section 1)).

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?

Any consumer product found to be perilous to a person's health or property and where the peril is unavoidable by any other means can, by the local regional state administrative agency under the supervision of the Safety and Chemicals Agency or by the Safety and Chemicals Agency itself, be ordered, inter alia, to be recalled at the expense of the distributor. The same applies to consumer products lacking the CE marking denoting conformity with the relevant EU requirements (Consumer Safety Act (920/2011), Chapter 6).

Freedom of contract provides that there are no restrictions on the agreement delineating which party shall be responsible for carrying out and bearing the cost of a recall.

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?

As a general rule, the principles of freedom of contract provide that there is no obstacle to this type of agreement between the parties, albeit not in relation to any third party. In addition, parties must take heed of the provisions permitting courts, at the request of the opposite party, to 'rewrite' the contract.

However, the Consumer Protection Act's period of six months' defect assumption from passing of the risk to the consumer cannot be validly limited to the disadvantage of a consumer. In terms of Finnish consumer law, a warranty always refers to the assumption of liability by the seller for the fitness or other characteristics of the goods or services, for a fixed period of time, and is, accordingly, to qualify as an advantage to the consumer. Any goods or services, whether consumer or not, must always meet the specifications set out in any guarantee statement or relevant advertising under pain of the consumer being eligible to claim cancellation of the purchase or, alternatively, price reduction and, in either case, compensation for their loss.

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?

Yes. The Data Protection Act (1050/2018; DPA) specifies and supplements the GDPR (Regulation (EU) 2016/679 of the European Parliament and of the Council on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC). The GDPR and the DPA put the supplier and its distribution under a number of obligations to ensure that all personal data is processed in accordance with the standards and requirements specified therein. For the purpose of the DPA, personal data means any information equal to the definition contained in article 4(1) of the GDPR. Pursuant to the main rule, transfer of personal data to a distribution partner of a third country is permissible only where there are appropriate safeguards for the data subjects, and on condition that enforceable data subject rights and effective legal remedies for data subjects are available. However, consent is not the only legal basis for processing personal data. Apart from processing for the performance of a contract to which the data subject is a party, the GDPR also allows processing for the legitimate interests of the data controller. This means processing for, among others, marketing and advertising purposes, even without the consent of the data subject, as well as for international data transfers and for profiling (ie, any form of automated processing of personal data consisting of the use of personal data to evaluate certain personal aspects relating to a natural person, in particular to analyse or predict aspects concerning that natural person's performance at work, economic situation, health, personal preferences, interests, reliability, behaviour, location or movements). On transfer of personal data to a third country, articles 44, 45 and 46 of the GDPR are applicable.

The title to data protected under the DPA is not regulated statutorily; therefore it must be deemed as being the property of the person who collected it, or his or her successor or assignee. Nevertheless, the non-disclosure obligation contained in section 35 of the DPA restricts, in practice, the exploitation of and thereby the ownership of any personal data.

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

Implementation of the data protection principles is required, including lawfulness, fairness, transparency, accuracy, purpose limitation, integrity, confidentiality, data minimisation and

storage limitation. This requires accountability, which means the distribution partners must be able to demonstrate compliance by implementing appropriate technical and organisational measures to ensure that the processing is in accordance with the GDPR.

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?

This type of contractual provision is, in principle, enforceable. However, apart from the risk of illegitimate use of the provision, it may, in practice, make the distributor the subordinate of the supplier to such a degree that it may be regarded as being an employee of the supplier.

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?

To be considered an employee, and be at least in part subject to labour law, the distributor or agent must be considered as acting under the direction and supervision of the supplier and, simultaneously, lacking the responsibility for financial risk. A small income alone may constitute a factor, putting the distributor or agent in a position equal to that of an employee. It may appear that the distributor or agent is submitted to work under the direction of the supplier where involvement, in person, is required; where the supplier is entitled, at its discretion or very frequently, to issue new instructions to the distributor or agent, the latter being required to adhere to those instructions and the supplier being allowed to monitor this adherence; or where the supplier is permitted to amend the contract at its discretion. Accordingly, importance is also placed on the consciousness and intent of the parties.

If the distributor or agent is found to be a de facto employee and not an entrepreneur, the result may be claims against the supplier for vacation benefits and protection against dismissal, termination or whatever severance an employee is considered to deserve under the Employment Contracts Act (55/2001) and, for social security purposes, claims from authorities considering the supplier liable for undeclared social security premiums. Although quite rare, being considered an employee for the purpose of the benefits extended under labour law may arise because of careless or negligent contract drafting or because the arrangement is allowed to degenerate into a state in which the distributor or agent is acting under the supplier's direction and supervision and not as an independent entrepreneur putting capital at risk. This may be the case where supplier-owned outlets are converted into franchises. One method of diminishing the risk of confusion that is advocated by some experts may be to ensure that the distributor or agent is a limited liability company rather than a sole proprietor.

Should the above criteria exist for the distributor or agent to be considered an employee, and should the distributor or agent, simultaneously, have failed to take out and maintain an insurance policy for at least the minimum statutory pension scheme in his or her trade, then for the purpose of pension insurance premiums, he or she may be regarded as an employee.

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Consequently, the supplier may become liable for those insurance premiums, including any in arrears as well as default interest.

If the above criteria exist for a distributor or agent to be considered an employee, and the distributor or agent fails to pay the advance taxes or the final taxes assessed, there is a risk that the tax authorities will consider the distributor or agent an employee and accordingly debit the taxes in arrears with the latter. Under these circumstances, the question of the supplier's vicarious liability also arises whereby the supplier may be held liable for the acts of the distributor or agent.

Whenever there is doubt as to whether the distributor or agent is to be regarded as an independent entrepreneur, it is advisable to seek a ruling from the tax authorities.

A supplier can protect itself against responsibility for potential violations of labour and employment laws by its distribution partners by means of not depriving the self-employed intermediary of its independence and by means of contractual stipulations to the effect that the distribution partners indemnify and hold the supplier not liable for any consequences of being deemed an employee, such as making good any amounts it may have to pay to the distributor as well as to any third parties for the benefit of the employees of the distributor.

Commission payments

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

The payment of commission is provided for under the Act on Commercial Representatives and Salesmen (417/1992) (sections 10 to 15). If the parties have failed to agree on the payment of commission, the commercial agent is still entitled to commission on any transaction concluded during the period of validity of the agency contract where the transaction has been concluded as a result of his or her action or with a third party whom the agent has previously acquired as a client for the principal for transactions of the same kind, or, if the agent has been entrusted with a specific geographical area or group of clients, the transaction has been concluded with a third party belonging to that area or group of clients.

Moreover, the agent is entitled to commission on any transaction concluded after the termination of the agency contract if the transaction has been concluded in the manner referred to above and the offer, whether to purchase or to sell, reached the principal or the agent prior to the termination of the agency contract, or if the transaction can be deemed to be mainly attributable to the contribution of the agent during the period of validity of the agency contract and the transaction was concluded within a reasonable period after the termination of the contract. Any contracting to the effect that the right to commission is to arise later than the time when the third party has fulfilled his or her performance obligation, or should have done so if the principal had fulfilled his or her performance obligation in accordance with the transaction, does not bind the agent.

Unless the agent consents thereto, the agent's right to commission is not affected should the principal agree with the third party on cancelling the transaction or amending its terms. In the absence of any agreement on the amount of commission payable, the commission shall be determined on the basis of the remuneration that is customarily paid for the execution of it or corresponding activities at the location of the agent's operation. If the amount of

the commission cannot be determined, the agent is entitled to a commission that is reasonable under the circumstances. The payment shall be effected by the end of the calendar month during which the commission accrued.

Good faith and fair dealing

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

The requirement that the contract must be negotiated and executed in good faith is emphasised in Finnish jurisprudence. The concept of good faith also underlies the Contracts Act, which is the basis of each and every distributorship founded on Finnish law. Accordingly, the principle of *culpa in contrahendo* is also emphasised. The carrying force is loyalty between the parties, and each party ought to deal loyally, also paying attention to the advantage of the other party. Therefore, when interpreting a contract, weight is primarily given to the following issues:

- In a given situation, how do parties normally act?
- What is to be assumed from the parties?
- What do prudence and due diligence require in any particular trade?
- What purposes does the contract serve?
- What outcome did the parties have in mind (any disloyal intentions)?
- At what stage did the parties find out relevant information?

For commercial transactions between the supplier and the distributor, the Sale of Goods Act is founded on the concept of good faith as well as fair dealing. The same is true with regard to the UN Convention on Contracts for the International Sale of Goods, which is the assumed applicable set of rules for the sale of goods in trade outside the purview of the Nordic countries. Insofar as the element of representation is concerned, the analogous application of the Act on Commercial Representatives and Salesmen (417/1992) requires that the duty of both the agent and the principal, among others, to act in good faith towards one another must be considered (sections 5, 8 and 9).

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. There is no requirement that the agreements as such should be registered with or approved by any authorities to be deemed valid or used for a particular purpose. However, where either party that is licensed to use an intellectual property right (IPR) desires that the licence be recorded by the relevant registry, non-mandatory recording is possible. Recording makes the licence effective against third parties, such as creditors.

In addition, a security interest by means of a pledge can generally be instituted by the recorded owner of the IPR. This is true for registered trademarks as well as patents, utility models, registered designs, layout designs and plant varieties. However, unregistered trademarks, trade names and copyrights cannot be used as security. A valid pledge of a

right to a registered trademark requires a writ of pledge and entry into the register of trademarks. Execution can be levied on a trademark only if the pledge is entered into the register. Regarding the pledge of a patent right, although there are no formal requirements inter partes for being regarded as binding in relation to third parties, the pledge must be entered into the register of patents. In this respect, there are slight differences compared with other pledgeable IPRs.

Anti-corruption rules

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

Anti-bribery and anti-corruption laws, in their entirety, are applicable to suppliers and their distribution partners. Pursuant to Chapter 30 of the 1889 Penal Code (1889/39, as amended), a wide range of acts containing the taking or offering of bribes are encompassed by the punishable offence of bribery in business. Moreover, a host of other wrongful acts and corruptive behaviours are punishable and applicable to all conceivable arrangements concerning the distribution of goods or services.

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?

Apart from the mandatory and semi-mandatory law provisions, either restricting directly or any deviation from some certain provision, and those admitting the competent court to adjust a contract provision that is found to be unconscionable, there are no mandatory provisions except for good faith, fair dealing and loyalty between the parties.

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?

No. Under article 3 of the Rome I Regulation (Regulation (EC) No. 593/2008), the parties to a contract may subject a distribution contract to the law of a foreign country or may elect a foreign law to be applicable to a certain separable part of the contract. Nevertheless, regarding the choice of a foreign law, whether accompanied by the choice of a foreign tribunal or not, the choice must not prejudice the application of domestic mandatory rules from which no derogation can be made, such as the laws on consumer protection, product liability, and labour and employment; the personal data law; the law of tenancy; the law on restraints of competition; procedural rules as to intellectual property rights; and tax law.

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?

Yes, there are restrictions, although they do not seem to affect agency or distributorship contracts. The restrictions seem to be limited to matters outside the scope of Regulation (EU) No. 1215/2012 and the rules conferring special jurisdiction to consumers under section 4 of the Regulation as well as exclusive jurisdiction in certain matters under section 6. As prorogation of jurisdiction is provided for under article 25 of the Regulation to the effect that if the parties, regardless of their domicile, have agreed in the form prescribed that a court or the courts of a member state are to have jurisdiction to settle any disputes that have arisen or that may arise in connection with a particular legal relationship, then that court or those courts shall have jurisdiction, unless the agreement is null and void as to its substantive validity under the law of that member state. The jurisdiction shall be exclusive unless the parties have agreed otherwise.

Purported derogation agreements are also recognised, which are agreements to the effect that a certain court is (or certain courts are) to be regarded as foreclosed (ie, excluded) jurisdiction.

Parties can contractually agree to arbitration of their disputes instead of resorting to the courts. Arbitrations can be seated abroad provided that the seat of the arbitration is a signatory to the New York Convention.

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 courts available to suppliers and distribution partners to resolve their disputes on contract performance and commercial transactions are in the first instance the ordinary district courts. In civil cases, the proceedings start with the pretrial phase of the procedure, after which the case is adjourned to the main hearing. Alternatively, the case may be resolved during the partly written and partly oral pretrial procedure. Apart from the claims and merits of the case, the complexity and length of the procedure depend a great deal on, first, the quality and quantity of evidence to be presented and, second, the fact that each party is heard regarding the claim, its grounds and whatever evidence there is.

If the judgment or decision rendered, usually within one or two years, is contrary to expectations, an intention to appeal must be notified within a week and, generally, the appeal must be lodged within 30 days. The appeal procedure consists of written preparation and one or more hearings. The courts of appeal must arrange an oral hearing if the evidence

of the case has to be evaluated again or when a party so requests unless the appeal is, for example, clearly without merit.

The third and final instance is the Supreme Court, which has its seat in Helsinki. Its main task is to establish precedents, thus giving guidelines to the lower courts on the application of the law. The Supreme Court may grant a leave to appeal in cases in which a precedent is necessary for the correct application of the law, a serious error has been committed in the proceedings before a lower court or another special reason exists in law. Normally, the cases are decided on the basis of solely written material. The Supreme Court may, however, also conduct oral hearings and inspections.

Finally, the Market Court is the competent court as regards disputes about, inter alia, competition between firms and improper marketing. Redress is sought with the Supreme Court.

Foreign businesses are encouraged to use the local courts. There is a standing joke that foreign businesses can expect equally unfair treatment as anyone else.

The statute says that anyone who wishes to present evidence in advance for a case that is not yet pending must apply for permission to do so from a court of first instance. If his or her rights depend on the admission of the evidence and there is a danger that the evidence will be lost or that it will be difficult to present it later, and the presentation of the evidence is not for the purpose of obtaining information on an offence, then permission shall be granted. If the rights of another person depend on the presentation of the evidence, he or she may, if necessary, be invited to appear in court for the hearing. His or her costs shall be covered by the applicant. In those cases, no one may be required to appear as a witness or an expert witness in a court other than the court of first instance in the district in which he or she resides or is staying (Code of Judicial Procedure (AAD/1734), Chapter 17, section 10).

Once the case is pending, pretrial disclosure of documents (discovery) is implemented by the request of either party that the opposite party state whether he or she has in his or her possession written evidence or an object that may be relevant in the case, provided that the document or object be sufficiently identified by the requesting party (Chapter 5, section 20, paragraph 2 of the Code of Judicial Procedure). When it can be assumed that a document is of significance as evidence in a case, the person in possession of the document can be ordered on pain of a fine to present it in court (Chapter 17, sections 10 to 17 of the Code of Judicial Procedure).

One advantage of a foreign business resolving a dispute in the Finnish courts is the direct enforceability against a Finland-domiciled party or one with property in this country. Another is that the court fees and dispatch costs are fairly low. In addition, as Swedish is formally a domestic language equal to Finnish, another advantage is that should a person wish to have his or her case tried completely in Swedish, he or she is entitled to expect the case to be tried as thoroughly as if it was in Finnish. Certain matters, such as applications for injunctive relief, are often rendered on a timely basis, and effectively handled by able judges and service-minded court clerks. However, a serious drawback is that as there is no statutory ceiling in respect of the prevailing party's attorneys' fees to be compensated by the defeated party, the risk of litigation tends to increase rapidly and uncontrollably.

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, this type of agreement is enforceable, although whatever decisions that mediation may bring forth are, in contrast to arbitral awards rendered in a New York Convention country, not enforceable. However, the award must be recognised. This is dependent on whether the arbitration agreement on which the award has been founded fulfils the formal requirements, and it must not be contrary to Finnish public policy. The party against whom enforcement of an arbitral award is sought shall, in general, be heard. Accordingly, should the party against whom enforcement is sought be able to demonstrate that one or more of the aforementioned obstacles exists, the award is not to be enforced.

An arbitration agreement concluded under Finnish law must be made in writing. This requirement is fulfilled if the agreement is contained in a document signed by the parties or in an exchange of letters between the parties. The written form requirement is also regarded as fulfilled where the parties, by exchanging emails, have agreed that a dispute shall be decided by one or more arbitrators. Any stipulations concerning the arbitration tribunal, the location of the arbitration or the language of the arbitration are matters that may affect the decision on whether the rule of the Contracts Act allowing the competent dispute resolution body (be it a court or arbitral tribunal) to adjust a contract provision found to be unconscionable should be applied.

The main advantages for a foreign business resolving a dispute with a business partner by arbitration in Finland are avoiding the quagmire of what, at worst, may evolve from any ordinary court, the fact that the hearings are not public, the finality of the award and the ambitiousness and dedication often demonstrated by arbitrators, resulting in elaborated and well-founded awards that in turn lead to continued demand for the fairly well-paid assignment of acting as arbitrator. The disadvantages are the expenses for both counsel, compensating the arbitrator or arbitrators for their work and expenses and, for the defeated party, the lack of any way of seeking redress.

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 more that services nowadays are either interwoven or otherwise contained in the goods sold, or goods being the object of services sold, such as updating, advertising, insurance or transportation, the more frequent is questioning about the meaningfulness of the narrow definition of a commercial agent under the Finnish Act on Commercial Representatives

and Salesmen (417/1992). Pursuant to the statute, the commercial agency is delimited to entrepreneurs 'who, in a representation contract concluded with another, the principal, has undertaken continuously to promote the sale or purchase of goods on behalf of the principal by obtaining offers for the principal or by concluding sales or purchase contracts in the name of the principal'. In other words, this narrow definition delimits the commercial agent under Finnish law to agents in respect of goods only, not services, despite the fact that services are now frequently either intertwined or contained in the sale of goods, or services, such as freight, packaging and insurance, and are included in the price on which commission is paid and any indemnity at termination is calculated. The trend seems to be that it be recognised that the agent who forwards to or concludes the sale of services on behalf of the account of his or her principal is in need of protection and indemnification at termination as much as the one who promotes the sale of goods. In the 1990s, this conclusion had already been reached the Turku Court of Appeal, who, in an illustrative judgment, applied the act on agency to the sale of advertisements. The ever-increasing sale of leasing contracts for goods, franchising concepts, solutions, and whatever machinery or equipment accompanied with an undertaking for updating and service lasting for decades, the latter being clearly the predominant portion of the sale, seems to have launched a snowball effect that calls for an amendment in the near future of the above-mentioned act on agency at the risk that the sphere of agents qualifying as commercial agents will shrink to merely those promoting the sale of commodities, merchandise and chattels.

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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.

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.

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.

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).

Equity interests

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

Yes.

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.

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.

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.

Agency contracts

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.

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 antitrust law, in rare cases, demands 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).

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 (pending is a case at the ECJ on the calculation of indemnity (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). To retain the indemnity, the commercial agent needs to notify the principal within one year from 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)*.

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).

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.

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).

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).

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. 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.

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 in paragraphs 46 et seq). Only specific limits apply 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).

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).

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.

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).

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).

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.'

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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)).

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.

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.

A supplier may require that e-commerce sales by its distribution partners (not, however, by their customers) 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.

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 distributor or the supplier itself;
- 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.

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.

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 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).

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).

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).

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.

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 property by 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).

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.

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).

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 concerning individual 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.

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).

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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.

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).

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 generally approve or reject managers if the agent or distributor has to render the services in person. However, the distribution partner is free to employ assistants unless the parties have agreed on a veto right for the supplier.

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.

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 as a supplier's employee if the agent is not independent. 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.

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 paragraph 1 page 1 alt 2 HGB) for intensified, existing customers to protect the commercial agent from direct business of the entrepreneur 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, Issue1;
- commission as soon as the principal has executed the transaction (section 87a, paragraph 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 above-listed rules are mandatory and cannot be waived or contracted out. Further details on the payment of commission (unless otherwise agreed) are provided under section 86b et seq of the HGB. If a contract procured by the 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, *ERGOPoist'ovňa*). In that case, the 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).

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.

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

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.

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).

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.

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.

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).

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.

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).

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?

Revised Vertical Block Exemption Regulation

In July 2021, the European Commission published the proposeddraft 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 (i) are concluded

vertically (= between non-competitors); (ii) between companies with market shares up to a maximum of 30%; and (iii) 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:

- 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, *ZVertriebsR* 2021, 293 et seq. and, with a structural synopsis, Rothermel/Rohrßen, IHR 2022, 221-230.

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 court 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.

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Cross and omnichannel distribution

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 future VBER will most likely have an impact on how to regulate such dual distribution.

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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.

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.

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 regarding their interest in other companies, and their competency to act as directors of the proposed company.

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.

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.

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.

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 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.

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.

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. There is no other statutory restriction on a supplier to terminate 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.

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. If so, 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.

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.

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 on the ground that any such dealing by the distributor may result in a breach of confidentiality covenants.

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 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.

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.

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.

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.

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 statutory or legal restrictions on a seller preventing it from charging different prices to different customers based on location, type of customer, quantities purchased or any other parameters.

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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.

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 the disposal or sale of the goods will be considered void if they cause or are likely to cause an AAEC in India. Similarly, an agreement restricting the customers to whom the distribution partner may resell the products is void if it causes or is likely to cause an AAEC in India.

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.

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.

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.

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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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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?

Since there are no statutory or legal restrictions to the contrary, 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.

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.

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.

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.

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.

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 the 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.

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.

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.

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 (whether in India or a foreign country) or choice of arbitration tribunals to resolve disputes, this choice must be made carefully, based on the manner of enforcement of judgments of foreign courts by local courts and the enforcement of 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).

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.

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.

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?

Currently, there are no proposals for new regulations or amendments of existing regulations concerning the distribution of products. However, there is a proposal to amend the existing data protection laws. When this is implemented, it may impact suppliers and distributors.

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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.

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.

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 (the 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.

Restrictions

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

Provided no risks exist for national security, Dutch law does not restrict foreign businesses from operating in the Netherlands or limit foreign investment in or ownership of Dutch business entities.

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.

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 2023 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 26.9 per cent in 2023. In many cases, if a Dutch BV is held by a foreign-resident entrepreneur, Dutch taxation is limited to the Dutch dividend withholding tax, insofar as is allowed under the applicable 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 within the territory of a member state of the European Union. These requirements also apply if the non-Dutch supplier has a fixed establishment for VAT purposes in the Netherlands.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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).

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.

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.

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.

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.

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.

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.

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.

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?

This is not applicable in the Netherlands.

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?

This is not applicable in the Netherlands.

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.

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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.

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.

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).

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.

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.

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). Further to this Order, on 13 December 2022, the European Commission launched the process towards the adoption of an adequacy decision for the EU–U.S. DPF. The draft adequacy decision will now go through its adoption procedure. Once this procedure is completed, the Commission can proceed to adopting the final adequacy decision.

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 that were 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.

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.

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.

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.

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

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- 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.

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.

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.

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 318-ter 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 €87,000. 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.

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.

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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.

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.

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 the 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.

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.

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?

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. This Order outlines the implementation steps that the United States will undertake in furtherance of the EU–US Data Privacy Framework (DPF). Further to this Order, on 13 December 2022, the European Commission launched the process towards the adoption of an adequacy decision for the DPF, which will foster safe trans-Atlantic data flows and address the concerns raised by the CJEU in *Schrems II*. The draft adequacy decision will now go through its adoption procedure. Once this procedure is completed, the Commission can proceed to adopting the final adequacy decision.

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DIRECT DISTRIBUTION

Ownership structures

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

Yes.

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

Yes.

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 best-suited and most common legal entities for an importer owned by a foreign supplier are the corporation (AG or SA) and the limited liability company (GmbH or Sàrl).

Legal entities such as corporations and limited liability companies are governed by the Swiss Code of Obligations.

The minimum share capital is 100,000 Swiss francs for the corporation and 20,000 Swiss francs for the limited liability company. The entities are established when the founding members – one founder is sufficient – declare by notarial deed that they are forming a corporation or limited liability company, adopt the articles of association and appoint the members of the governing bodies.

Restrictions

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

Swiss legal entities must be able to be represented by a Swiss resident (citizenship is irrelevant) with sole signatory power or two Swiss residents with collective signatory power. These persons are registered with the commercial register.

Additional restrictions apply with regard to real estate. The Federal Act on the Acquisition of Real Estate by Persons Abroad restricts the acquisition of real estate in Switzerland by foreigners. Nevertheless, real estate used for permanent commercial purposes, such as manufacturing or retail premises or offices, may be acquired.

Equity interests

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

Generally, yes. Restrictions may apply if the local entity owns real estate in Switzerland.

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?

Switzerland is a confederation of 26 cantons (states) with currently about 2,150 municipalities. A distinction is to be made between direct federal, cantonal and municipal taxes. The Swiss cantons set their own corporate tax rates. This system leads to a certain degree of tax competition between the cantons and municipalities and, therefore, to relatively low tax rates.

The Confederation, cantons and municipalities all levy taxes on profits. For the Confederation the rate is 8.5 per cent. There are significant differences between the tax rates of different cantons and municipalities. For example, the canton of Zug offers attractive tax rates; the total tax burden on the profits (ie, including federal, cantonal and municipal taxes) amounts to less than 15 per cent.

All cantons levy taxes on equity. Here again, there are significant differences between the tax rates of different cantons and municipalities. In the canton of Zug, the tax rate on equity amounts to less than 1 per thousand.

Furthermore, companies whose turnover exceeds a threshold of 100,000 Swiss francs per year are usually subject to value-added tax (VAT) and must therefore register with the Federal Tax Administration. The ordinary VAT rate is 7.7 per cent (as from 2024: 8.1 per cent). A reduced VAT rate of 2.5 per cent (as from 2024: 2.6 per cent) applies to goods such as foodstuffs, pharmaceuticals or print products (books, newspapers, journals, etc).

Dividends paid are subject to a 35 per cent withholding tax. Swiss residents are able to obtain a full refund of the withholding tax. Shareholders residing outside of Switzerland can receive relief from Swiss dividend withholding tax insofar as this is provided for in a double taxation treaty.

There is no specific transfer pricing legislation in Switzerland and there are no particular documentation requirements in this respect. Nevertheless, general Swiss tax law provisions require that transactions among related parties must be at arm's length and commercially justified.

LOCAL DISTRIBUTORS AND COMMERCIAL AGENTS

Distribution relationships

7 What alternative distribution relationships are available to a supplier?

Swiss contract law is based on the principle of freedom of contract, which allows parties to define the conditions that will govern their contractual relationship at their own discretion. Swiss law is very liberal and particularly attractive for suppliers. Mandatory provisions protecting distributors are rare.

Therefore, a supplier may choose from many possible distribution structures and tailor this structure to its needs. The following distribution structures are frequently used:

- Distribution or wholesale agreements, under which distributors or wholesalers purchase products from suppliers and resell them in their own name and account to their customers.
- Franchise relationships, under which franchisees distribute products and services independently, but under a distribution concept provided by the supplier (franchisor). In exchange for a franchise fee or other forms of compensation, franchisees receive ongoing assistance, training and advice from the supplier (franchisor) and may use the latter's labels, trademarks, know-how, equipment or other items or intellectual property rights. The franchisor usually reserves the right to issue directives and, thus, to maintain a significant degree of control over the business activities of the franchisee.
- Commercial agency agreements, under which commercial agents undertake to act on a continuous basis as an intermediary for one or more principals in facilitating or concluding transactions on their behalf, without, however, entering into an employment relationship with their principals. Commercial agents are usually remunerated by means of sales commissions based on the transactions that were facilitated or concluded during the agency relationship.
- Commission agreements, under which commission agents sell the products in their own name but for the account of the supplier. In return, they are entitled to commissions. Commission agents are rather rare in Switzerland.

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 Swiss Code of Obligations (CO) regulates Swiss contract law. The First Division of the CO (articles 1 to 183 CO) contains general principles of Swiss contract law. These principles also apply to agreements governing distribution relationships.

Some distribution-related contracts, namely commercial agency agreements and commission agreements, are specifically governed in the Second Division of the CO.

However, the CO does not explicitly govern numerous other kinds of distribution-related contracts, for example, distribution, wholesale and franchising agreements. They are considered to be 'innominate contracts', to which other provisions relating to nominate contracts; for example, agreements for the sale of goods, commercial agency agreements, employment agreements or lease agreements may apply by analogy. For instance, certain employment provisions may apply by analogy to certain franchising agreements. Commercial agency-related provisions, notably the entitlement to a goodwill indemnity pursuant to article 418u CO, might apply by analogy to certain exclusive distribution agreements.

The general principles set forth in the Swiss Civil Code (eg, the duty to act in good faith and the prohibition of an abuse of law) also apply to distribution-related contracts. Moreover, parties to distribution-related contracts must comply with the Federal Cartel Act and the Federal Unfair Competition Act. Numerous further laws may apply to parties to distribution-related contracts; for example, tax laws, product safety and liability laws or sector-specific laws (eg, in the foodstuffs or pharmaceutical markets).

As to industry self-regulatory constraints, reference should be made to the Code of Conduct of Swiss Distribution, the former Swiss Franchise Association. The Code of Conduct is binding upon members of Swiss Distribution and contains, for example, rules on pre-contractual disclosure.

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?

Generally, no. Freedom of contract entails the freedom to terminate distribution relationships. Parties to distribution relationships can freely (and should) agree in their agreement on the applicable notice periods and on whether any specific cause is required. These agreements can, for example, also combine fixed terms with premature termination rights. Swiss courts tend not to interfere with such contractual termination rights.

However, there are a few exceptions, in particular minimum notice periods for commercial agency agreements: where a commercial agency agreement is concluded for an indefinite period and has lasted for more than one year, it may be terminated by giving two months' notice expiring at the end of a calendar quarter. This notice period cannot be shortened in the agreements.

Moreover, a supplier who holds a dominant position in a market, or who is relatively dominant (ie, if another company is economically dependent on the supplier), may be obliged to continue a distribution relationship at least for a certain period of time based on the Federal Cartel Act.

Swiss contract law provides that either party may terminate a long-term contract with immediate effect at any time for good cause, even if this termination right is not included or explicitly excluded in an agreement. Any circumstance that renders the continuation of the

distribution relationship in good faith unconscionable and unreasonable for the party giving notice constitutes such good cause. Ongoing violations of a distributor's exclusivity rights by the supplier or a lasting failure of the distributor to distribute or pay for the goods are possible examples of these circumstances.

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

Such entitlement to mandatory compensation ('goodwill indemnity' or 'compensation for clientele') may exist in particular under commercial agency agreements (article 418 of the CO).

If an agent's activities have resulted in a substantial expansion of the principal's customer base and considerable benefits accrue after the end of the agency relationship to the principal from business relations with customers acquired by the agent, the agent is entitled to a goodwill indemnity, provided this is not inequitable. However, the agent has no entitlement where the agency relationship has been dissolved for a reason attributable to the agent. The goodwill indemnity can amount up to the agent's net annual earnings from the commercial agency relationship.

Article 418u CO may apply by analogy to exclusive distribution agreements, meaning that exclusive distributors can also be entitled to a goodwill indemnity under certain circumstances. An analogous application of article 418u CO to exclusive distribution agreements requires that a distributor be integrated to a large extent into a supplier's distribution organisation, so that the exclusive distributor finds itself in an agent-like position and disposes of only limited economic autonomy.

The parties to an agency or distribution agreement cannot validly exclude an entitlement to a goodwill indemnity in their agreement.

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. Prohibitions on assigning distribution-related rights to third parties are very common. Assignments in violation of these prohibitions are null and void.

Clauses prohibiting distributors or agents from selling their businesses to third parties are not enforceable as such. However, it is common to stipulate extraordinary termination rights with immediate effect in the case of such transfers of ownership (change of control clauses).

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. Confidentiality agreements can also provide for contractual penalties or liquidated damages in the case of breaches of confidentiality. However, Swiss courts may reduce the amounts of these penalties and damages if they consider them excessive.

In addition, it should be kept in mind that violations of confidentiality obligations may also qualify as a misdemeanour under the Swiss Criminal Code.

Competing products

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

Restrictions on the distribution of competing products in distribution agreements are enforceable only if they comply with the Federal Cartel Act and, in particular, the Competition Commission's (COMCO) Notice regarding the Competition Law Treatment of Vertical Agreements (the Verticals Notice) and the Explanatory Note to the Verticals Notice.

According to the Verticals Notice, distribution agreements with non-compete obligations for an indefinite period (unless the distributor can effectively renegotiate or terminate the agreement with a reasonable period of notice and at a reasonable cost) or a fixed period exceeding five years are deemed to significantly restrict competition and are likely to be considered unlawful. This also applies to post-contractual non-compete obligations, with a few narrow exceptions.

Prices

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

Restrictions on the distribution partner's price-setting freedom are only enforceable if they comply with the Federal Cartel Act and, in particular, the Verticals Notice.

Under the Cartel Act, agreements between suppliers and distributors regarding fixed or minimum prices (resale price maintenance (RPM)) are generally prohibited. RPM clauses are vigorously prosecuted by COMCO. Parties to distribution agreements containing RPM clauses may be fined up to 10 per cent of the turnover achieved in Switzerland in the preceding three financial years. In practice, these fines are mostly imposed only on the suppliers.

An exception to the prohibition of RPM exists with regard to commercial agency agreements. In principle, principals under commercial agency agreements can determine the prices for

the transactions, which are facilitated or concluded by agents on their behalf. However, for that purpose, it is important that agents do not bear any significant risks.

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?

Suppliers may influence resale prices to a limited extent by setting maximum resale prices or by communicating non-binding resale price recommendations.

Specifically with regard to resale price recommendations, it must be safeguarded that these suggested resale prices do not become tantamount to fixed or minimum prices owing to the exercise of pressure by the supplier or economic incentives that cause the distributor to comply with the suggested prices. Recommended resale prices are also problematic if they are automatically transmitted by the supplier to electronic POS systems of distributors or directly printed on the product in Swiss francs without explicitly stating that the resale price recommendations are non-binding. Resale price recommendations are less problematic if they are publicly accessible and expressly non-binding. Moreover, even without pressure from or incentives by the supplier, resale price recommendations may be inadmissible in case of a very high level of adherence to the price recommendations.

In the case of a selective distribution system, suppliers may also set high qualitative requirements to be complied with by all authorised distributors (eg, demanding a luxury retail environment). This will generally lead to higher costs on the part of the authorised distributors and thereby result in higher prices.

Minimum advertised price policies are likely to be qualified as an unlawful form of RPM and could give rise to turnover-based administrative penalties.

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. However, some exceptions may exist, in particular with regard to online platforms. In 2015, COMCO prohibited online travel agencies from obliging hotels not to offer lower prices on other platforms. Moreover, since 1 December 2022, the Unfair Competition Act prohibits parity clauses in general terms and conditions between online booking platforms and hotels. Further exceptions may apply in the case of a dominant or relatively dominant position.

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 principle, sellers are allowed to charge different prices for different customers. However, the Federal Cartel Act prohibits dominant or relatively dominant sellers from discriminating between trading partners in relation to prices or other conditions of trade. If committed by dominant sellers, such abuses of dominance may be fined up to 10 per cent of the turnover achieved in Switzerland in the preceding three financial years.

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?

Geographic areas and categories of customers can be restricted if the restriction complies with the Federal Cartel Act and, in particular, the Verticals Notice.

Under the Cartel Act, clauses contained in distribution agreements regarding the allocation of territories are prohibited to the extent that sales by other distributors into these territories are not permitted. In Switzerland, even exclusive sourcing obligations imposed on distributors may be qualified as an unlawful restriction of passive sales and lead to turnover-based fines, despite the fact that such exclusive sourcing obligations would benefit from the block exemption under EU competition law and be admissible. Therefore, the admissibility of exclusive sourcing obligations should be assessed carefully.

According to the Verticals Notice, a supplier may generally restrict active sales efforts by the distributor into an exclusive geographic territory or to an exclusive customer group reserved to the supplier itself or allocated to up to five other distributors, provided that these restrictions do not limit passive sales; responses to unsolicited orders from customers from other geographic territories or other categories of customers must still be possible.

In principle, internet sales are considered to be passive sales unless a website or marketing efforts 'actively' target customers from another exclusive territory.

Exclusive territories, also limited to active sales efforts, are generally not permitted in the case of selective distribution systems. A combination of selective and exclusive distribution within the same territory qualifies as a severe restriction of competition. However, under the new Verticals Notice, which entered into force in January 2023, exclusive distribution systems may serve to some extent as an alternative to selective distribution systems, as they allow a supplier to exclusively allocate a geographic territory or customer group to up to five distributors or resellers. In such an exclusive distribution system, active sales to other territories or customer groups can be prohibited, but passive sales to non-authorised distributors must remain possible.

Since 1 January 2022, the Federal Cartel Act also prohibits the restriction of the ability of customers to purchase goods or services offered in Switzerland and abroad at the market prices and customary terms and conditions applicable abroad, if customers try to purchase such goods or services abroad and such restrictions are implemented by dominant or relatively dominant undertakings. This prohibition also applies intra-group (ie, between suppliers and their own subsidiaries). Moreover, with regard to e-commerce sales, the Unfair Competition Act prohibits the discrimination of customers regarding prices and payment terms, restrictions of access to online interfaces or the redirection of customers to another online interface on the basis of the customer's nationality, place of residence, location of the customer's payment service provider or the place of issue of the customer's payment instrument.

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

Unlawful geographic restrictions, in particular prohibitions imposed by suppliers on foreign distributors to respond to unsolicited orders from Swiss-based customers (ie, prevention of parallel imports), are an enforcement priority of COMCO and vigorously prosecuted. Parties to distribution agreements containing an allocation of territories to the extent that passive sales by other distributors into these territories are not permitted may be fined up to 10 per cent of the turnover achieved in Switzerland in the preceding three financial years. This even applies in case of an indirect prevention of passive sales (eg, through exclusive sourcing obligations). In practice, these fines are mostly imposed only on the suppliers.

The same fine may also be imposed on dominant undertakings that restrict the ability of customers to purchase goods or services offered in Switzerland and abroad at the market prices and customary terms and conditions applicable abroad if customers try to purchase such goods or services abroad.

Unlawful customer restrictions may be prohibited by COMCO but cannot trigger direct turnover-based fines. These fines can be imposed only if the unlawful restrictions are maintained despite a decision of COMCO that specifically prohibits these restrictions.

In addition, unlawful geographic and customer restrictions can lead to private actions. However, private enforcement of competition law rules in Switzerland is rare.

Online sales

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

In principle, e-commerce sales are considered to be passive sales unless a website or marketing efforts 'actively' target customers from another exclusive territory. Therefore, suppliers cannot restrict or prohibit e-commerce sales outside the territory exclusively allocated to a distributor. 'Invasion fees' or similar amounts payable by the distributor in the case of (passive) sales into the exclusive territory of another distributor are generally unlawful. However, suppliers may set qualitative requirements to be complied with by distributors.

With regard to e-commerce sales, it is also important to note that a geo-blocking prohibition in the Unfair Competition Act, which is similar to the prohibition set forth in EU Regulation 2018/302 on addressing unjustified geo-blocking and other forms of discrimination based on customers' nationality, place of residence or place of establishment within the internal market, exists. Specifically, it is prohibited to discriminate between customers regarding prices and payment terms, restrict or block access to online interfaces or redirect customers to another online interface without objective justification on the basis of the customer's nationality, place of residence, location of the customer's payment service provider or the place of issue of the customer's payment instrument.

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?

Generally, yes. Territorial restrictions imposed on the supplier are likely to be lawful. Therefore, claims to invasion fees or similar amounts payable by the supplier are likely to be enforceable.

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?

Based on the principle of freedom of contract, undertakings can freely choose their contractual partners and decide on which terms they are willing to conclude a contract. Therefore, a refusal to deal with particular customers is generally lawful.

However, there are important exceptions. A refusal to deal may amount to an abuse of a dominant position under the Federal Cartel Act if a supplier holds a dominant position on a relevant market, or is at least relatively dominant.

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, distribution or agency agreements do not fall under the Swiss merger control rules. If concluded between competitors, distribution or agency agreements may rather give rise to concerns under article 5 of the Federal Cartel Act (ie, the statutory provision governing anticompetitive agreements).

However, it cannot be excluded that distribution or agency agreements may under (very) exceptional circumstances fall under the merger control rules. This could be the case if these agreements allow one undertaking (eg, the supplier) to exercise a decisive influence over the activities of the other undertaking (eg, the distributor). In such a case, an acquisition of control in terms of the Merger Control Ordinance would exist. Nonetheless, even franchising agreements, which typically provide a franchisor with far-reaching rights to issue directives and, thus, to maintain a significant degree of control over the business activities of the franchisee, do not usually fall under the merger control regime.

Moreover, the establishment of a joint venture in connection with a distribution or agency relationship could also trigger merger control obligations, for example, if two undertakings set up a joint venture for the joint commercialisation of goods or services. If two or more undertakings establish a new joint venture, the joint venture is reviewable if it performs all

the functions of an autonomous economic entity on a lasting basis and if business activities from at least one of the controlling undertakings are transferred to the joint venture.

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?

Under the Federal Cartel Act, all agreements that eliminate effective competition or significantly restrict competition in a market for specific goods or services and are not justified on grounds of economic efficiency are prohibited. These agreements are null and void.

To set out under which conditions agreements affecting competition are justified on grounds of economic efficiency, COMCO issued the Verticals Notice, which generally follows the European Vertical Block Exemption Regulation, but with some important differences (eg, regarding the prevention of passive sales through exclusive sourcing obligations and recommended resale prices, where Switzerland follows a stricter approach than the EU). In addition, COMCO also published short explanatory guidelines on the Verticals Notice. In the motor vehicles sector, a separate notice and guidelines exist.

The Verticals Notice and the accompanying explanatory guidelines address, inter alia, RPM, exclusivity rights granted in relation to geographic territories or customer groups, selective distribution systems (ie, 'closed' systems of authorised distributors selected on the basis of certain requirements), exclusive distribution systems, non-compete obligations or certain restrictions in the e-commerce sector.

In addition, the Cartel Act also addresses abusive conduct by dominant and relatively dominant undertakings, such as refusals to deal, discrimination of trading partners, tying and bundling practices or restrictions of the freedom of customers to purchase goods and services abroad.

An undertaking is relatively dominant if another company is economically dependent on such an undertaking. Such dependence exists if the other company (eg, a distribution partner) does not have sufficient and reasonable possibilities to switch to another undertaking (eg, another supplier), for example, in case of specific investments, high switching costs, must-stock products or required spare parts. Relative dominance is a bilateral concept (ie, the relationship between the specific supplier and the specific distribution partner must be assessed). The Secretariat of COMCO has published an explanatory note on relative dominance.

The rules set forth in the Cartel Act are enforced by COMCO and its Secretariat. The Secretariat investigates conducts investigations and disposes of far-reaching investigative powers, including the right to conduct dawn raids and summon witnesses. On the basis of the outcome of investigations, COMCO renders its decision, prohibits unlawful conduct and imposes fines. It may also approve an amicable settlement concluded between the Secretariat and the undertakings concerned.

Parties to distribution agreements containing RPM clauses or an unlawful allocation of territories to the extent that passive sales by other distributors into these territories are

not permitted may be fined up to 10 per cent of the turnover achieved in Switzerland in the preceding three financial years. The same fines can be imposed on undertakings that abuse their dominant position on a specific market. No dominance-related turnover-based fines can be imposed on undertakings that are merely relatively dominant.

COMCO may also prohibit other anticompetitive clauses contained in distribution agreements, but this does not lead to direct turnover-based fines. These fines can be imposed only if such restrictions are maintained in spite of a decision of COMCO that specifically prohibits the restrictions.

In addition, anticompetitive agreements or abuses of dominance or relative dominance can lead to private actions. Private parties hindered by unlawful anticompetitive conduct from entering or competing in a market are entitled to request the elimination of or desistance from the anticompetitive conduct, damages and the surrender of unlawfully earned profits. However, private enforcement of competition law rules in Switzerland is rare.

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?

Parallel or 'grey market' imports are difficult to prevent under Swiss law. Indeed, COMCO vigorously fights against any unlawful attempts to prevent parallel or grey market imports.

Distributors and agents may require the supplier or principal to act against other distributors or agents that actively target the exclusive territory of another distributor or agent. However, if – as is usually the case – parallel imports are the result of passive sales (ie, the fulfilment of unsolicited orders by distributors located in another territory) there are no viable means to prevent these parallel or grey market imports.

Even in the case of a 'leakage' within a lawful selective distribution system (ie, a 'closed' system of authorised distributors selected on the basis of certain requirements), there are generally no viable ways to prohibit an unauthorised distributor from selling the products in Switzerland. Swiss intellectual property laws do not allow the proprietor of IP rights to oppose further commercialisation of the goods if these goods have been placed on the market with the proprietor's consent anywhere in the world in the case of trademark or copyright-protected goods or in the European Economic Area in the case of patent-protected goods (with a few exceptions, for example, pharmaceuticals).

As of 1 January 2022, the Federal Cartel Act also prohibits the restriction of the ability of customers to purchase goods or services offered in Switzerland and abroad at the market prices and customary terms and conditions applicable abroad if customers try to purchase such goods or services abroad and such restrictions are implemented by dominant or relatively dominant undertakings. This prohibition also applies intra-group (ie, between suppliers and their own subsidiaries).

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?

Based on the principle of freedom of contract, the supplier and distributor may agree to divide or to pass the advertising costs entirely to one party. Swiss courts do not generally interfere with these rules.

The Federal Unfair Competition Act imposes restrictions regarding the advertisement of products. Generally, any behaviour that may be considered deceptive or which violates the principle of good faith and that affects the relationship between competitors or between suppliers and customers is unlawful. This includes, for example, incorrect or misleading statements about a competitor's products or own products, and incorrect or misleading comparisons.

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?

Most importantly, suppliers should develop a suitable IP protection strategy. In principle, suppliers are well-advised to protect inventions by means of patents in accordance with the Federal Patent Act and to register trademarks and designs with the Federal Institute of Intellectual Property in accordance with the Federal Trademark Act and the Federal Design Act.

Protection of IP rights in Switzerland from abroad is relatively simple. For example, Switzerland is party to the Madrid international trademark system, the Hague international design system, the Patent Cooperation Treaty and the European Patent Convention.

In the case of a (threatened) infringement of its IP rights, a supplier may request the competent court, inter alia, to prohibit an imminent infringement or remedy an existing infringement, or both. Prior to the initiation of ordinary proceedings, it is also possible to obtain an (ex parte) preliminary injunction in summary proceedings. Furthermore, an action for damages, the surrender of unlawfully earned profits or a reasonable royalty may be brought in accordance. The supplier may also file a criminal complaint.

The Swiss Trademark Act explicitly states that trademarks registered in the name of the distributor without the consent of the supplier, or trademarks that remain entered in the Swiss trademark register after the withdrawal of this consent, are not protected.

As to the protection of trade secrets and know-how, it is important to implement adequate contractual, organisational and technical measures to prevent unauthorised access to and use of such trade secrets and know-how. This includes, for example, the conclusion of strict confidentiality agreements (reinforced by contractual penalties) prior to the exchange of

trade secrets. Breaches of trade secrets may also qualify as a misdemeanour under the Swiss Criminal Code.

Technology transfer agreements fall under the category of 'innominate contracts' and are commonly used in Switzerland. It is important to make sure that these technology transfer agreements comply with competition law rules.

Consumer protection

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

Switzerland does not have a specific consumer protection law. Consumers are protected through several laws, including the Federal Unfair Competition Act, the Ordinance on the Indication of Prices, the Federal Product Safety Act and the Federal Act on Consumer Credits.

Furthermore, certain provisions protecting consumers can also be found in the Swiss Code of Obligations (CO) (eg, revocation rights in door-to-door sales and similar contracts) or the Swiss Civil Procedure Code (eg, mandatory jurisdiction rules).

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 Federal Product Safety Act stipulates several post-market obligations of the manufacturer or distributor of products that are intended for consumers. The manufacturer or distributor must take adequate measures to recognise the potential risks arising from the use of its product, to prevent such danger and to trace back the product. The measures may include, for example, a product recall.

In principle, in accordance with principle of freedom of contract, parties to a distribution agreement are free to allocate 'internally' obligations in connection with carrying out recalls and the bearing of the costs thereof to one of the parties. However, towards the authorities and consumers, these internal agreements cannot be invoked as a defence in the case of a non-compliance with obligations under the Product Safety Act.

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 may agree to limit or even fully exclude any warranties to its distribution partners. However, a limitation or exclusion of warranties obligation is void if the supplier has fraudulently concealed the failure to comply with the warranty from its distribution partner. This applies to warranties provided by the distribution partners to downstream customers, even if these downstream customers are consumers.

In principle, downstream customers do not benefit from any warranties provided by the supplier if they have not purchased products directly from the supplier. These warranties exist only if the supplier explicitly grants them. Otherwise, the downstream customers have to hold their own contractual counterparty (ie, the distribution partner) accountable, which may again take recourse to the supplier.

However, the supplier and the distribution partner may be liable towards customers based on the Federal Product Liability Act, regardless of the existence of a direct contractual relationship with the person who suffered harm. Liability under the Product Liability Act is mandatory.

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 Switzerland, the Federal Data Protection Act (FDPA) restricts the exchange of information about customers and end-users. Personal data may only be processed for the purpose indicated at the time of collection, that is evident from the circumstances, or that is provided for by law. The collection of personal data and, in particular, the purpose of its processing must be evident to the data subject.

Under the current FDPA, not only data pertaining to natural persons, but also data pertaining to legal entities falls under the FDPA.

Suppliers and distributors should also pay attention to cross-border disclosure of personal data. In this regard, personal data may not be disclosed abroad if the privacy of the data subjects would be seriously endangered thereby, for example, owing to the absence of legislation that guarantees adequate protection.

It should be noted that the Swiss parliament adopted a revision of the FDPA in September 2020, which includes numerous adaptations to the EU's General Data Protection Regulation (GDPR), but retains its own basic concept and also deviates from the GDPR in various aspects. The revised FDPA will enter into force on 1 September 2023.

Finally, it is important to note that an exchange of information between a supplier and its distribution partners about customers and end users of products may also be prohibited under the Swiss Cartel Act and the Verticals Notice in dual distribution structures (ie, if the supplier and the distributor also compete with each other in relation to the distribution of the supplier's products, for example, due to online sales of the supplier).

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

Personal data must be protected against unauthorised processing through adequate technical and organisational measures (TOM). Such TOMs are further governed in the Data Protection Ordinance.

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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 accordance with the principle of freedom of contract, a supplier may approve or reject the individuals who manage the distribution partner's business if this right is stipulated in the distribution agreement.

Similarly, the distribution agreement may also stipulate that the supplier shall be entitled to terminate the distribution relationship if it is not satisfied with the management of the distribution partner.

An exception may apply with regard to commercial agency agreements, at least if the statutory minimum notice period of two months is not complied with. If a termination owing to non-satisfaction with the management of the distribution partners does not respect the two-month notice, 'qualified' circumstances tantamount to a good cause for a termination with immediate effect should exist.

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 treated as an employee of the principal if the characteristics of an employment relationship exist. This requires that the agent is subordinated to the principal in a manner similar to an ordinary employee (ie, obliged to perform its work in strict compliance with the principal's general directives and specific instructions). Furthermore, to be qualified as an employee of the principal, the agent should not bear any entrepreneurial risks.

If a commercial agency relationship is (re)qualified as an employment relationship, the principal must comply with numerous mandatory employment law provisions, including protection against abusive termination, paid vacations and the obligation to make social security contributions.

As to distribution relationships, it is rather unlikely that a distributor will be treated as an employee of the supplier, as distributors act as resellers and, therefore, bear significant entrepreneurial risks. However, an exception may apply with regard to franchisees. In the case of a strong subordination of franchisees to the franchisor, certain protective provisions of Swiss employment law may apply by analogy.

The supplier can reduce the risk of an application of employment law provisions by limiting the level of control and influence that it exercises over agents, distributors or franchisees, and making sure that the latter bear an entrepreneurial risk (eg, by being responsible for providing the necessary infrastructure and hiring supporting staff at their own costs). It is also common practice to obtain a confirmation from the competent social security authority that the agent has been recognised as self-employed.

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Moreover, employees of a distributor or agent may potentially also become employees of the supplier if the supplier terminates the distribution relationship and (re)integrates the distribution of its products vertically. In such a case, the provisions on the transfer of a (part of an) undertaking may apply. If there is such a risk, that risk should be addressed in the distribution or agency agreement, for example, by including a suitable indemnification clause.

Commission payments

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

Pursuant to the CO, and subject to deviating rules in the commercial agency agreements, commercial agents are entitled to the commission on all transactions concluded during the commercial agency relationship. Further, agents are entitled to a commission on transactions concluded during the commercial agency relationship without the agent's involvement but with customers acquired by the agent. In addition, agents to whom a particular territory or customer group has been allocated exclusively are also entitled to the commission on all transactions concluded during the agency relationship with customers belonging to that territory or customer group.

At the end of the commercial agency relationship, the agent is generally entitled to commission on orders placed by a customer acquired by the agent during the commercial agency relationship only if these orders are placed before the end of the commercial agency agreement.

Special entitlements to commission or compensation exist if agents assume liability for customers' payment obligations or are empowered by the principal to collect payments from customers.

Good faith and fair dealing

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

The duty to act in good faith and the prohibition of an abuse of law pursuant to article 2 of the Swiss Civil Code also apply in distribution relationships. For instance, information exchanged between the parties during contract negotiations must be accurate and must not be misleading. Important information shall not be suppressed.

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, there is no such requirement. However, the registration of intellectual property licence agreements in the patent, trademark or design register may be advisable from a licensee's perspective, since this registered licence will prevail over later rights acquired in the relevant patents, trademarks or designs by third parties. In addition, licence agreements without registration are generally not considered bankruptcy-proof.

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Anti-corruption rules

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

Anti-bribery laws also apply to distribution relationships. According to the Swiss Criminal Code, active and passive bribery of private individuals constitutes a misdemeanour. Active bribery consists in promising or giving, and passive bribery consists in demanding or accepting from, for example, an employee or agent of a third party in the private sector an undue advantage so that the person carries out or fails to carry out an act in connection with his or her official activities that is contrary to his or her duties or dependent on his or her discretion.

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?

Some distribution-related contracts, in particular commercial agency agreements, are specifically governed in the Swiss Code of Obligations. Most agency law provisions are non-mandatory (ie, they only apply if the parties do not agree on a different solution). However, there are some mandatory rules, such as the minimum two-month notice period as from the second year of the relationship, the entitlement to a goodwill indemnity and the entitlement to special compensation if the agents assume liability for customers' payment obligations or undertake to comply with post-contractual non-compete obligations.

With regard to other kinds of distribution-related contracts (eg, distribution, wholesale and franchising agreement not explicitly governed by the CO), less prohibited or mandatory contractual provisions exist. In these cases, the entitlement to a goodwill indemnity pursuant to article 418u CO or the inalienable right to terminate a distribution agreement with immediate effect for good cause may become of particular importance.

If the parties to a distribution agreement do not address certain issues, the general principles of Swiss contract law set forth in the First Division of the CO (articles 1 to 183 CO) apply. These principles will be deemed to be included even if they are not explicitly mentioned in the distribution agreement.

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, no. The Federal Act on Private International Law provides the parties to a distribution contract with the possibility to choose the law governing the agreement. This choice of law should be in writing. The parties' freedom to choose the governing law might,

however, be limited. Certain mandatory rules of countries other than the chosen one can apply, notwithstanding the parties' will. For example, the relevant competition law applies where the concerned activities have an impact, regardless of the parties' choice of law.

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?

Generally, no. Pursuant to the Lugano Convention and the Federal Act on Private International Law, the parties to a distribution agreement are generally free to choose the Swiss or foreign court or arbitration tribunal that shall resolve existing or future disputes arising out of the distribution agreement. In principle, a contractual choice of courts or arbitration tribunals should be in writing (ie, signed by all parties).

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 principle, disputes between suppliers and distribution partners are resolved by the ordinary Swiss courts. In most cantons, there are two instances on the cantonal level. In the cantons of Zurich, Bern, Aargau and St Gallen, commercial courts will act as the sole cantonal instance for claims above 30,000 Swiss francs.

The procedures depend on the amount in dispute. In principle, the ordinary procedure applies to disputes with an amount in dispute exceeding 30,000 Swiss francs. A mandatory conciliation hearing before a conciliation authority generally precedes court proceedings. Faster summary proceedings apply, for example, in the case of an application for a preliminary injunction.

In their decisions, Swiss courts can oblige a party to pay a specific amount of money to the other party or order injunctive relief (ie, specific performance of certain contractual obligations). Declaratory relief, including negative declaratory relief, is available under certain circumstances.

Generally, the Swiss Civil Procedure Code obliges the parties to cooperate during the taking of evidence. This includes, for example, the disclosure of sufficiently specified documents or testimony from the other party. Unlike in some countries with extensive pretrial discovery rules, 'fishing expeditions' or motions for the disclosure of broad categories of documents are not admissible in Switzerland.

Foreign businesses are generally not restricted in their ability to make use of these courts and procedures and can expect fair treatment. From a supplier's perspective, the advantage

of litigation in Switzerland is that Swiss courts will most likely not apply any mandatory rules existing in other jurisdictions. Therefore, a choice of Swiss courts facilitates the enforcement of the clauses stipulated in the agreements, in particular owing to the liberal character of the Swiss Code of Obligations. Nonetheless, at least the courts of other European countries must recognise and enforce judgements of Swiss courts on the basis of the Lugano Convention.

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. Switzerland is a very arbitration-friendly venue and is party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. In principle, under the Federal Act on Private International Law all pecuniary claims may be submitted to arbitration.

Advantages of resolving a dispute by arbitration in Switzerland include the confidentiality of arbitration proceedings and the very limited possibility of challenging international arbitration awards before the Swiss Supreme Court.

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?

On 1 January 2023, the revised Notice regarding the Competition Law Treatment of Vertical Agreements (Verticals Notice) and the accompanying Explanatory Note of the Swiss Competition Commission entered into force. The Verticals Notice and the Explanatory Note have been revised following the adoption of the revised Vertical Block Exemption Regulation and the Guidelines on Vertical Restraints on the European level in May 2022.

In September 2020, the Swiss parliament adopted the new Federal Data Protection Act (FDPA). The revised FDPA includes numerous adaptations to the EU's General Data Protection Regulation (GDPR), but retains its own basic concept and also deviates from the GDPR in various aspects. It will enter into force on 1 September 2023.

On 1 January 2022, an important revision of the Federal Cartel Act entered into force and has introduced the concept of relative dominance into Swiss law. A further larger revision of the Cartel Act is currently ongoing, albeit at an early stage. The content and outcome of that revision are open.

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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 generally is free to establish a distribution subsidiary in the United States. Doing so can have several benefits, such as:

- serving as a liability shield for the supplier;
- simplifying payments and contract terms with customers (because the transaction and related payments will be between US entities); and
- giving the foreign supplier options as to the form in which it receives income from the United States (eg, as dividends instead of product purchases).

Establishing a US subsidiary will have tax, transfer pricing, staffing and other consequences. The foreign supplier should work through these considerations with its accounting team, tax advisers and other advisers.

Federal or state laws in a few specific industries (such as national defence, banking and alcoholic beverages) restrict foreign ownership and may block establishment of a subsidiary. In addition, US embargoes and sanctions could prohibit formation of a subsidiary. The Office of Foreign Assets Control of the US Department of Treasury maintains lists of embargoed countries and blocked individuals and entities.

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

Yes, generally, a foreign supplier can be the partial owner of its importer or distributor, with exceptions for certain industries and any applicable US embargoes or sanctions.

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 both tax and non-tax considerations in choosing the form of an entity. The basic choice is between a corporation and a limited liability company (LLC). Although various partnership and limited partnership forms are sometimes available, they are not likely to be best suited. At a high level, the most important trade-offs between a corporation and an LLC are these:

- A corporation is taxed at both the corporate level and the shareholder level, whereas an LLC is taxed like a partnership (ie, treated as a pass-through entity, where the LLC's earnings and losses pass through the LLC to its owners, and each owner's respective share of earnings or losses is included on the owner's tax return). If the LLC has only

one 'member' (equity owner), it may even be disregarded entirely for tax purposes and not have to file tax returns at all. However, for the foreign supplier and other non-US investors, a corporation may still be preferable from a tax perspective. Tax treaties between the US and the foreign supplier's home country (or the lack thereof) may also affect the decision.

- LLCs are easier to set up and more flexible than corporations in terms of management and governance. The owners enter into an operating agreement or company agreement that defines how the LLC will be managed. The LLC can be member-managed, or it can be run by one or more 'managers' who need not be members. The powers of the members and managers are defined by contract in the operating agreement. By comparison, corporations have more legal formalities that must be observed (eg, a corporate charter, by-laws and a board of directors), as well as compliance with regulatory reporting requirements. Compliance with these formalities may involve significant legal costs.
- A corporation is usually a better choice if the business entity will have more than a small number of owners. For LLCs, managing and documenting ownership changes can be unwieldy, and it is more difficult for an LLC to offer equity incentive plans to executives and employees.

Corporations and LLCs are formed under state law by filing organisational documents with the chosen state. The laws of that state will govern the internal affairs of the business entity and the relationships among the owners and the entity. From a state tax perspective, there may be an advantage to forming in one of the six states that do not have a corporate income tax at the state level or one of the seven states that do not have personal income tax at the state level. But as a practical matter, the overall state tax burden may depend more on where the business entity transacts business than on where it is organised.

There are also non-tax considerations to deciding where to organise. The state of Delaware has been the leading choice for many years, not because it lacks corporate income tax (it has one), but because it has an extremely well-developed body of corporate law and special courts with expertise in business entity issues. Delaware is the closest thing in the United States to a 'national' law of corporations. Nevada is another state that has made an effort to make itself attractive for incorporation. Texas is also friendly for business formation, but its business entity codes are somewhat more parochial.

Another non-tax consideration is where the foreign supplier wishes to establish the US headquarters. The simplest approach is to form the subsidiary in the state where it will be headquartered, although the benefit is minor if the company will operate nationwide. Companies formed in one state often have to register to do business in other states as they go along. If the subsidiary incorporates in Delaware but establishes headquarters in California, for example, the subsidiary would have to register to do business in California as a foreign (non-California) corporation.

Finally, another non-tax consideration is which state law the foreign supplier wishes to govern the contracts of its subsidiary. For a contractual choice of governing law to be enforceable, the subsidiary must have a valid connection to the state chosen, either by incorporation or its principal office. For example, for Texas law to apply, the subsidiary should incorporate there or have its office there, or both.

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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.

Equity interests

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

Yes, generally, a foreign supplier can own an interest in its importer or distributor, with exceptions for certain industries and subject to any applicable US embargoes or sanctions.

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?

US income taxation is a complicated subject involving federal, state and local taxing authorities. The information below is limited to US federal income taxation. Foreign suppliers wishing to do business in the United States should consult professional tax advisers. Income tax treaties between the United States and the foreign supplier's home country can affect the preferred structure and the tax burden from US operations.

Foreign businesses and individuals are subject to US federal income tax on income that is deemed to be 'effectively connected' with a US trade or business, in the same manner as if they were US persons. A foreign corporation that has effectively connected income (ECI) is also subject to a 30 per cent branch profits tax on after-tax net income that is repatriated from the United States to the foreign home office. If a branch continually reinvests its income to expand the US business, it will not be subject to the branch profits tax until it actually repatriates the US income.

Being 'engaged in a trade or business' is not defined in the US Internal Revenue Code or related regulations. However, the supplier will always be deemed to be engaged in US

business if employees of the foreign supplier perform services within the United States. Fact-specific revenue rulings by the US Internal Revenue Service and case law provide guidance on when a US trade or business exists in other circumstances. In general, the decisions establish that activity in the United States must be 'considerable, continuous, and regular' to constitute a US trade or business. Being engaged in a US trade or business is determined separately for each taxable year.

If the foreign supplier has ECI, it must file a US federal income tax return. The foreign supplier is entitled to deduct effectively connected expenses of the US business from the income reported. If the foreign supplier invests in a US operating business, either directly or through an entity treated as a partnership for US income tax purposes, the supplier itself will still be required to file a US tax return and pay taxes on its share of ECI generated by the operating business.

Generally, all US-sourced income of the foreign supplier (as determined by US tax laws) is considered to be effectively connected with the US trade or business and is subject to US income tax. Accordingly, the foreign supplier must determine whether its income is from a US source or a foreign source for US tax purposes. There are different sourcing rules for different types of income under US tax law. Sales income is generally sourced where legal title passes.

Income tax treaties, where applicable, may raise the threshold of when a foreign company is subject to US tax on business income. For example, income tax treaties may include permanent establishment provisions. These provisions generally specify that a foreign person is not engaged in a US trade or business unless it has a fixed place of business in the United States or there is a dependent agent that regularly concludes contracts on its behalf within the United States.

Income that is US sourced but is not ECI is treated as 'fixed or determinable annual or periodic' income (FDAP). FDAP income includes but is not limited to interest, dividends, rents, royalties and annuities. FDAP income paid to the foreign supplier is subject to 30 per cent US withholding tax. The withholding rate may be reduced by income tax treaties.

Forming a US subsidiary corporation can alleviate some of the federal tax burdens for a foreign supplier if the subsidiary employs the individuals who perform services in the United States and holds the investment in US-operating businesses. In particular, the foreign supplier would avoid the branch profits tax and could avoid withholding tax on dividends if the subsidiary does not make distributions to the parent until winding up its affairs. Depending on the foreign supplier's structure and home country tax rules, it could be beneficial for the foreign supplier to structure the US subsidiary as a US partnership entity that elects to be treated as a corporation for US tax purposes.

LOCAL DISTRIBUTORS AND COMMERCIAL AGENTS

Distribution relationships

7 What alternative distribution relationships are available to a supplier?

A foreign supplier has a wide range of choices for structuring its distribution system in the United States. They include:

- direct distribution using the supplier's own employees;
- distribution through a subsidiary formed or acquired by the supplier;
- distribution through one or more independent distributors that buy goods from the supplier and resell them at a profit to their own customers, typically under a written distribution agreement that defines the rights of the supplier and distributor;
- distribution using commercial agents or sales representatives who do not purchase from the supplier or take title to the goods. Commercial agents arrange sales on behalf of the supplier and receive a commission when the supplier fulfils the direct sale to the customer. The commercial agent agreement may cover responsibility for other functions as well, such as invoicing, delivery and other logistics;
- distribution through a franchise network. If the distribution relationship meets the legal definition of a franchise, regulations apply at the federal level and at the state level in many states;
- distribution by means of licensing manufacturing rights, where the supplier grants a US manufacturer the right to use intellectual property to make the supplier's products locally, subject to quality controls, and to sell them through the licensee's own distribution network or agreed channels; and
- private label distribution, in which the supplier applies the US distributor's brand to the products, sells them at a profit to the US distributor, and essentially surrenders control over their subsequent sale, distribution, marketing and advertising in the United States.

In theory, a foreign supplier could use more than one of these methods (or other hybrids) contemporaneously in the United States, perhaps in different geographic areas or for different products, although doing so could be a management challenge. The supplier could also enter into a joint venture with a US distribution partner by investing in the partner or jointly forming a new entity.

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?

There is no regulatory scheme in the United States applicable to distribution agreements as a general class. In most cases, parties are free to enter into a distribution relationship on whatever terms they choose, without any mandated terms or formalities or oversight by any government body. General principles of contract law will apply. However, there are several bodies of law that can or will come into play, depending on the goods or services involved in the relationship.

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Product distributorships are subject to article 2 of the Uniform Commercial Code (UCC), which deals with transactions in goods. Article 2 has been adopted, with various adjustments, in every US state except Louisiana. Article 2 will apply if the sale of goods is part of the relationship; in some states, the sale of goods must be the dominant or predominant part of the relationship for the UCC to apply. However, provisions of the UCC are not mandatory; rather, they act in a gap-filling capacity when the private contract of the parties fails to cover a particular issue. The parties are generally free to adopt contract provisions that vary from article 2. UCC provisions address the formation and modification of a contract for the sale of goods, the performance obligations of seller and buyer, and breach and remedies.

Certain federal and state statutes govern distribution relationships in particular industries. At the federal level, the Automobile Dealers Day in Court Act and the Petroleum Marketing Practices Act govern supplier relationships with automobile dealers and gasoline retailers, respectively. At the state level, the industries affected include car, truck and motorcycle dealers, farm equipment dealers, construction and industrial equipment dealers, liquor wholesalers, beer and wine distributors, boat and snowmobile dealers, appliance dealers, and garden equipment dealers, among others.

If the distribution relationship meets the legal definition of a franchise, regulations apply at the federal level and at the state level in many states. Franchise investment laws apply to the formation of the relationship and require presale disclosure to prospective franchisees and, in certain states, registration of the franchise offering. Franchise relationship laws regulate termination, non-renewal, ownership transfers and other aspects of the relationship between the franchisor and the franchisee.

Some industries have self-regulatory codes of conduct, but they do not have legal force unless incorporated into the contract between the supplier and distributor.

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?

In general, the parties to a distribution agreement can specify the grounds and procedures for termination, and the contract provisions will be enforced unless deemed by a court or arbitrator to be unconscionable or contrary to public policy. However, if a federal or state dealership law applies to the relationship, the statute may supersede the termination provisions of the contract. Dealership statutes typically require good cause for termination, as well as notice of default and an opportunity to cure. Most of them provide that good cause includes failure by the dealer to comply with any lawful (and in some cases, material or reasonable) requirement of the agreement. Most but not all of the statutes define good cause in a non-exhaustive manner, leaving room to argue that good cause exists even in circumstances where the facts do not match any of the examples of good cause in the statute. Some statutes specify circumstances (such as the distributor's voluntary abandonment of the business, conviction of a crime, or repeated defaults) in which the supplier is

not required to provide notice and an opportunity to cure. No two statutory formulations are exactly alike, so the specific statute must always be consulted.

If no dealership statute applies, the terms of the distribution agreement will govern. If the parties have not specified conditions for termination, then UCC provisions may apply.

A few states and US territories have statutes governing termination of dealerships generally. These include Alaska, Delaware, Maryland, Rhode Island, Wisconsin, Puerto Rico and the US Virgin Islands.

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

Generally, distributors are not entitled to compensation or goodwill indemnity upon termination or expiration of a distribution arrangement. A few special industry laws require the supplier to repurchase inventory from a terminated distributor, but, generally, there is no goodwill indemnity based on clientele developed by the distributor.

If the foreign supplier violates the terms of the contract or an applicable statute prohibiting termination without good cause, the terminated distributor may sue for damages or an injunction to block termination. Damages for wrongful termination may be measured by the fair value of the distributor's business in the supplier's product line or by the net present value of the profits the distributor would have earned but for the termination.

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, contractual restrictions on the distributor's transfer of equity ownership, business assets, or distribution rights will be enforced. However, in certain industries, statutes limit the supplier's ability to restrict ownership transfers. For example, state laws governing motor vehicle dealers often require good cause for refusal to approve an ownership transfer.

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 US distribution agreements are generally enforceable on the same basis as confidentiality agreements in other contracts.

Competing products

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

Restrictions on the distribution of competing products are generally enforceable. Such exclusive dealing arrangements are subject to challenge under federal antitrust laws if they substantially decrease inter-brand competition by foreclosing competitors of the supplier from reaching the market. But exclusive dealing has never been treated as per se unlawful; US courts apply the 'rule of reason', under which all relevant factors are considered to determine the actual or likely competitive effects of the restriction, including the market power of the parties, market structure, the strength of inter-brand competition, the justifications for the exclusivity, and the geographic scope and duration of the restriction. Restrictions that continue after the end of the relationship must be ancillary to the contract (ie, in furtherance of the legitimate purposes of the contract). As a practical matter, antitrust challenges to exclusive dealing will not succeed if the supplier lacks market power and competing suppliers can compete effectively by selling to other distributors or through alternative distribution channels.

In addition to antitrust law, restrictions on competition are governed by state law, usually as a matter of the common law of contracts but sometimes as a matter of statute. In most states, the courts have not expressly distinguished between covenants not to compete that apply during the existence of the agreement and covenants that apply after its expiration or termination. Where the courts have made a distinction, they have applied more lenient standards toward in-term covenants. Indeed, in-term covenants are often drafted without a geographic restriction and are, nevertheless, generally enforceable.

Most judicial decisions on covenants not to compete under state law involve the enforceability of post-term restrictions. The courts in most states will evaluate the reasonableness of a post-term covenant in terms of its duration, geographic scope and activities prohibited. In California, however, a statute of general applicability voids any post-term covenant not to compete unless specifically exempted by the statute. The statute contains no exemption for distribution agreements, though it does have one that may apply upon dissolution of a joint venture. Thus, a supplier may not enforce a contract provision that prohibits a former California independent distributor from dealing in competing products. In contrast with California, a Texas statute affirmatively requires the enforcement of covenants not to compete that meet certain reasonableness standards.

Prices

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

Imposing controls over a distributor's resale prices (also known as resale price maintenance (RPM)) is possible but involves risk under US federal and state antitrust laws. Overall, the risk is much lower than it was in the past, but there is an important distinction between maximum and minimum price restraints. A maximum price restriction is a low risk today,

except in unusual circumstances. A minimum price restriction is a higher risk, and the risk varies between federal and state law and among the states.

For decades, dictating a buyer's resale prices was deemed to be per se illegal under US federal law – ie, illegal without regard to proof of anticompetitive effects in the particular case. Under this rule, a supplier could not set either the maximum price or the minimum price at which an independent distributor would resell the supplier's goods. However, in 1997, the US Supreme Court changed the federal antitrust rules with respect to setting maximum resale prices. Ten years later, the US Supreme Court similarly changed the rules with respect to setting minimum resale prices. Under these landmark decisions, vertical price restraints – whether maximum or minimum prices – are tested under the rule of reason, a facts-and-circumstances test that results in a violation of federal antitrust law only if the restrictions are proven to have an actual anticompetitive effect. This is extremely difficult to prove in any competitive industry.

State law, however, is another issue. While state and federal law are generally consistent regarding maximum resale price restrictions, the 2007 US Supreme Court decision changing the federal rule for minimum resale prices was controversial. After that decision, the state of Maryland passed a law confirming that it remained illegal to set minimum resale prices in Maryland. And the state attorneys general in California and New York took the position that minimum price restrictions remained automatically illegal under their state laws as well. Both continued to take enforcement actions under state law against minimum price restrictions. Most other states have not expressly addressed the issue.

In practice, there have been few recent lawsuits or state government enforcement actions, even by California or New York, targeting minimum RPM in distribution networks. One possible reason is that few suppliers, in practice, have been setting minimum resale prices, because of the continued uncertainty and risk at the state level. Foreign suppliers wishing to set minimum prices for independent US distributors must understand that this practice could still be considered per se illegal in certain states. When suppliers impose resale pricing restrictions, they are usually maximum prices.

Another possible reason for the lack of RPM lawsuits and enforcement actions is that suppliers have been able to satisfy their business objectives by using techniques that US courts have found not to constitute RPM, such as minimum advertised price (MAP) policies.

If a supplier wishes to establish minimum resale prices, it is essential to articulate a procompetitive business rationale for the policy, to support the supplier's position in the case of a challenge. For example, makers of luxury goods sometimes set minimum retail prices out of concern that deep discounting will damage their brand image or discourage investment in retail facilities and services needed to compete effectively with other brands, or both. The key here is that the minimum price policy promotes competition with other brands – it does not just inflate the price paid by customers.

If the supplier, rather than selling through independent entities in the United States, is selling through outlets it owns, a controlled subsidiary or a bona fide agent, it is considered a direct sale and the supplier is free to control the price.

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?

Suggesting resale prices or choosing not to deal with customers who do not follow the supplier's pricing policy do not constitute resale price maintenance, as long as the supplier is genuinely acting unilaterally and the customer remains truly free to make its own pricing decisions. It is only agreements between the supplier and customer on resale prices that raise antitrust implications under US law. Such an agreement can be created, however, if the supplier takes steps to enforce compliance with its policy. These steps may convert the suggested price or unilateral policy into a coerced agreement, which could be challenged as unlawful.

Generally, MAP policies have been found not to constitute RPM as long as they only control the price at which the distributor advertises and not the actual sales price. In practice, the less separation in time and space between the advertisement and the actual sale, the greater the risk that the supplier's restriction on advertising may be viewed as restricting the actual sale price. The distinction is trickier with online sales, where a single click may be all that separates display of the item from the checkout where the transaction is completed. The MAP policy may legitimately restrict the price shown when the item is displayed, but restricting the price shown in the online shopping cart or at checkout is more likely to be viewed as restricting the actual sales price. The product display itself may signal that the customer will see the actual price when the customer places the item in the shopping cart.

Suppliers may also use cooperative advertising programmes, in which the supplier offers to subsidise the cost of the distributor's advertising provided that the advertising follows the supplier's pricing policy.

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?

US courts generally have found most favoured nation (MFN) or most favoured customer clauses to be enforceable, although occasionally noting that they can have anticompetitive effects in certain circumstances. A recent search turned up 54 federal cases involving MFN clauses and only four state cases. There had been only one reported federal appellate court decision in the three years preceding the search. Most of the federal cases were at the district court level and many involved healthcare providers. The most noteworthy case was U.S. v. Apple, in which MFN clauses in Apple's contracts with publishers of e-books were held to violate antitrust law. The MFN clause required publishers to lower the price at which they sold e-books in Apple's store if the books were sold for less anywhere else, such as Amazon.

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 federal Robinson-Patman Act prohibits certain forms of price discrimination by a seller between competing buyers. The Robinson-Patman Act applies only to the sale of tangible goods. If one distributor must pay the supplier a higher price for goods than the supplier

charges to other buyers with whom the disfavoured distributor competes, the disfavoured buyer may be able to assert a price discrimination claim. A competing seller also can challenge price discrimination.

The jurisdictional requirements for a claim under the Robinson-Patman Act are many, and proof of a violation is difficult. Government enforcement actions are rare, and private plaintiffs must prove that the price difference had a reasonable possibility of causing injury to competition. In addition, the statute provides the supplier with certain defences to a claim. The cost justification defence applies if the supplier can prove that the price differential only makes due allowance for differences in the cost of manufacture, sale or delivery to the competing customers. The meeting competition defence applies if the supplier can prove that it acted in good faith to meet an equally low price of a competitor. Both defences are notoriously difficult to prove.

Quantity discounts, though not automatically lawful under the Robinson-Patman Act, are commonplace in the United States and rarely problematical.

The Robinson-Patman Act also prohibits a supplier from granting advertising and promotional allowances and services to customers unless they are available to all competing customers on proportionally equal terms.

Some states have laws modelled on the Robinson-Patman Act that similarly restrict price discrimination, and some restrict charging different prices in different parts of the same state. Industry-specific laws for distribution of motor vehicles, alcoholic beverages, etc, may also prohibit supplier discrimination in pricing to dealers in those industries.

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?

Generally, the parties to a distribution agreement are free to determine any restrictions on the territory within which, or the customers to whom, the distributor may sell. They are also free to determine the scope of any exclusivity granted to the distributor for the designated territory or customers. An exclusive distributorship is one in which the distributor receives the right to be the sole source for the supplier's products in a given area or for a given set of customers.

US courts apply the rule of reason in assessing vertical restraints such as exclusive distributorships, territorial restrictions and customer restrictions under the antitrust laws. Courts will consider the market power of the parties, the market structure, the strength of interbrand competition, the geographic scope and duration of the agreement, and any other relevant factors to determine the actual or likely competitive effects of the arrangement. These restrictions are rarely found to be unlawful in the absence of market power.

However, there is a major caveat: horizontal market allocation among competitors remains per se illegal under the US antitrust laws. If a territory or customer restriction is not truly

vertical, but rather is one that the supplier imposed at the insistence of distributors to facilitate the distributors' desire to allocate territories or customers, it will be viewed as horizontal and per se illegal. The supplier will have legal exposure for participating in the scheme.

US law does not have specific rules for active versus passive sales.

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

Geographic and customer restrictions can be challenged by federal and state antitrust agencies and by private parties in litigation. However, these restrictions are rarely found to be unlawful in the absence of market power or evidence that they were part of a scheme of horizontal market allocation.

Online sales

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

In principle, suppliers can prohibit distributors from e-commerce sales (either on a distributor site or a third-party platform) and from use of social media if the supplier wishes to reserve those channels to itself or another reseller. Like any other vertical non-price restraints, such restrictions will be subject to antitrust challenge if they have net anticompetitive effects on inter-brand competition, but not simply because of the nature of the restriction. US law does not have specific rules for online versus offline activities, active versus passive sales, or single-brand versus multi-brand resellers.

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?

Generally, the parties to a distribution agreement are free to determine the scope of any exclusivity granted to the distributor, and this may include restrictions on supplier sales through e-commerce or other channels.

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 is generally free to decide unilaterally whether to deal with particular customers. However, if the supplier is a monopolist or if its refusal is part of a conspiracy with other suppliers or distributors to restrain competition, the refusal could be subject to challenge under US antitrust laws. In practice, most courts have upheld refusals to deal under the rule of reason after examining the supplier's reason for refusing to deal and its effect on competition.

Downstream restrictions on a distributor's ability to deal with particular customers is a type of vertical restraint. Like other vertical restraints, this restriction would be reviewed under the rule of reason and upheld against antitrust challenge unless found to have net anticompetitive effects on inter-brand competition considering all relevant factors. These restrictions are rarely found to be unlawful in the absence of market power.

Under certain special industry statutes, suppliers have a statutory obligation to deal with all customers. For example, in many states, alcoholic beverage wholesalers must sell to all licensed retailers.

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?

Entry into a distribution or agency agreement, standing alone, is not a reportable transaction under merger control rules and does not require agency clearance. However, if establishment of the relationship involves acquisition of a business or interests in a business, the transaction may be subject to federal antitrust agency review if it exceeds certain thresholds for size of transaction or size of the parties. Effective 4 March 2021, the threshold for the size-of-transaction test is US$92 million. Under the size-of-persons test, the transaction is reportable if one party has annual net sales or total assets of US$184 million or more and the other party has annual net sales or total assets of US$18.4 million or more, or if the transaction is valued at more than US$368 million regardless of the size of the parties. These thresholds are adjusted annually.

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?

All distribution relationships in the US are subject to federal and state antitrust (competition) laws. The principal federal antitrust statutes are:

- the Sherman Act;
- the Clayton Act;
- the Federal Trade Commission Act; and
- the Robinson-Patman Act.

All 50 states, the District of Columbia and the US territories of Puerto Rico and the US Virgin Islands have their own antitrust statutes. Most states, either by statute or by case law, give deference to precedent under the federal antitrust laws in applying their state antitrust statutes, but there are exceptions.

The federal and state statutes have general language that US courts have refined into more specific principles through a vast body of judicial decisions over many decades. The following

is only a general summary of the most common ways in which these laws may constrain the supplier–distributor relationship.

- Vertical non-price restraints: exclusive dealing arrangements, exclusive distributorships, customer restrictions and territorial restrictions are common types of vertical restrictions on distributors. They are called 'vertical' because the supplier and distributor are at different levels of trade. US antitrust agencies and courts have long tested the legality of vertical non-price restraints under a flexible rule of reason standard. This standard requires an analysis of the actual competitive effects of the restriction in a properly defined product and geographic market. In practice, vertical non-price restraints are rarely found to be unlawful, and then only in circumstances where the seller has market power. The courts generally hold that a seller with less than a 30 per cent share of the relevant market does not have market power.
- Vertical price restraints: vertical price restraints (also known as resale price maintenance) for decades were deemed illegal without regard to proof of anticompetitive effects in the particular case. Therefore, a supplier could not dictate either the maximum price or the minimum price at which distributors resold goods purchased from the supplier. However, the US Supreme Court changed the rules with respect to maximum prices and minimum prices, respectively, in landmark decisions handed down in 1997 and 2007. Under federal law, vertical price restraints are now tested under the rule of reason, just like vertical non-price restraints. At the state level, however, enforcement authorities in certain key states announced that they would not follow the new federal approach to minimum prices, and in many other states, courts and enforcement agencies have not expressly declared their position.
- Tying and bundling arrangements: a tying arrangement is one in which a supplier conditions the sale of one product (the tying product) on the distributor's agreement to purchase a separate product (the tied product) from the supplier, its affiliate or a third party from whom the supplier derives economic benefit. Under general principles of tying law, a tying arrangement will not be deemed unlawful unless the supplier possesses sufficient market power in the market for the tying product to enable the supplier to restrain trade appreciably in the market for the tied product. The same is generally true for bundling arrangements, in which the distributor is not required to purchase the second product, but the supplier's pricing policy for purchasing both products creates a powerful incentive not to purchase from competitors.
- Price discrimination: the Robinson-Patman Act prohibits certain forms of price discrimination by a seller between competing buyers of tangible goods. If one distributor must pay the supplier a higher price for goods than the supplier charges to another distributor with whom the disfavoured distributor competes, the disfavoured distributor may be able to assert a price discrimination claim. However, proof of a violation is difficult.

By contrast to vertical restraints, horizontal agreements among competitors at the same level of distribution are subject to different standards and much closer scrutiny. Horizontal agreements on prices, allocation of customers or territories, or production levels are per se illegal under the US antitrust laws and may give rise to both civil and criminal liability. It is therefore crucial for both suppliers and their distribution partners to avoid putting themselves and each other into a position where they might be deemed to be participants in a horizontal conspiracy.

Both government agencies and private parties can enforce the antitrust laws (except that private parties cannot enforce the Federal Trade Commission Act (the FTC Act) and certain portions of the Robinson-Patman Act). The US Department of Justice and the Federal Trade Commission (FTC) are the primary enforcers at the federal level, although only the former can seek criminal penalties. Both agencies can file civil actions for injunctions, civil penalties, disgorgement of profits and structural remedies. State attorneys general have similar authority in enforcing their respective state antitrust laws.

Private plaintiffs can sue for antitrust violations and, if successful, obtain injunctions and recover treble damages (ie, three times the actual damages) as well as their attorney's fees. Private antitrust litigation is typically very expensive because of the standards of proof, so more likely to be reserved for high-stakes situations where the defendant's financial exposure is elevated. Private actions are common and will often follow a public enforcement action or settlement by a government agency.

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?

Grey market goods are products with genuine trademarks that are legitimately manufactured and branded but intended for sale and distribution outside the United States. Grey market or parallel importation occurs when those products are purchased outside the United States and imported into the country without the trademark owner's consent.

Grey market goods are considered infringing only if the goods are not genuine because they have physical or other material differences from non-grey market goods. If the products are identical, then the distributor may resell that product, even into other territories, without that sale constituting infringement. Differences in pricing between products are not material differences in product quality. If a product has significant enough physical differences, however, the difference can impact the goodwill of the brand negatively in the United States. For instance, products for the US market might use different formulations (such as shampoo and dish detergent being sudsier), be labelled and packaged differently, or have instruction manuals only in English. Non-physical product differences can include differences in warranty protections, lack of product support and recalls, and inapplicability of product certifications (such as environmental or eco-friendly) obtained solely for the US market.

If the products are indeed materially different, then claims for trademark infringement can be brought at the US International Trade Commission (ITC) or in US district court. The trademark owner, not the distributor or agent, typically needs to bring or be joined in the claims. Typical US district court enforcement can be challenging owing to the need for the court to exercise jurisdiction over a non-US entity and the challenge in locating and serving process on the unauthorised reseller. Even once successful, the reseller can often begin using a different entity. The ITC is better equipped than US courts to enforce grey market goods owing to its ability to issue exclusion orders and to name multiple unauthorised resellers in a single action.

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?

Product marketing by suppliers and distributors is subject to generally applicable advertising law, which is mostly directed to protection of consumers. The FTC is the federal agency that oversees general advertising and marketing practices, while other agencies have oversight responsibilities in specific industries such as prescription drugs. The FTC's Division of Advertising Practices acts under the authority of section 5 of the FTC Act, which proscribes unfair or deceptive acts or practices in or affecting commerce. The two basic principles of FTC advertising law are that advertising must be truthful and not misleading and that the advertiser must have adequate substantiation for objective product claims before disseminating the advertisement. For some specialised products or services, additional rules apply. The FTC has published a variety of guides to assist advertisers with compliance, including specific resources for online advertising and marketing, telemarketing, 'Made in USA' claims, health and environmental claims, use of influencers and endorsements, and deceptive pricing practices. These resources can be accessed on the FTC's website.

Every state has its own 'Little FTC Act' prohibiting unfair or deceptive acts or practices. Both public agencies and private litigants can challenge advertising and marketing practices under these statutes. Some states, California in particular, also have other consumer protection statutes that provide additional remedies.

In addition, the federal Lanham Act provides competitors with a private cause of action for a supplier's or distributor's false or misleading advertising. The competitor must prove that the supplier or distributor used a false or misleading description or representation of fact in commercial advertising about its own or another's goods, services or commercial activities, and must show economic or reputational harm flowing from the defendant's deceptive advertising. Consumers do not have standing to bring a false advertising claim under the Lanham Act.

The parties to a US distribution agreement are free to agree that the distributor will bear the cost of advertising or share in the supplier's cost of advertising. However, if the supplier provides advertising or promotional allowances or services to distributors, the supplier should make the allowances available to all competing customers on proportionally equal terms to avoid potential liability under the Robinson-Patman Act.

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 should protect its intellectual property both through US registration, if applicable, and through contractual protections, such as non-disclosure agreements and covenants not to compete. If the supplier's marks (or copyrights, if applicable) are registered in the United

States for the products at issue, the supplier can register the marks with US Customs & Border Protection through the agency's e-Recordation Program. Through the Program, US customs partners with rights holders to enforce intellectual property rights at the border. For registered trademarks, the term of customs protection is concurrent with, and renewed at the same time as, the trademark registration. For registered copyrights, the term of customs protection is 20 years. However, parallel or grey market imports are not necessarily viewed as infringing.

Consumer protection

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

Consumer protection law in the United States is an amalgam of federal and state laws and regulations. Key federal consumer protection laws include the FTC Act, the Consumer Product Safety Act and the Federal Food, Drug and Cosmetic Act (this short list omits laws relating to personal finance and privacy). The consumer laws most likely to be relevant to suppliers and distributors generally are those relating to advertising and marketing practices and product safety.

The FTC Act proscribes unfair or deceptive acts or practices in or affecting commerce. US states have similar unfair and deceptive practices laws, often known as Little FTC Acts. Consumers do not have a private right of action under the FTC Act, but they do typically have private remedies under the analogous state laws. The FTC also enforces a long list of statutes and regulations targeted at particular industries and practices, including consumer product warranties, robocalls and offering of franchise opportunities, to name just a few.

The Consumer Product Safety Commission enforces the Consumer Product Safety Act, which requires reporting of potentially dangerous defects in consumer products and, in appropriate cases, product recalls.

The Food & Drug Administration regulates food, drugs, biologics, medical devices, cosmetics and tobacco.

At the state level, each state's attorney general or a state department of consumer affairs, or both, has authority to investigate and take action against violations of the state's Little FTC Act. These laws also provide a private right of action to consumers (and in some cases to businesses as well). Some states, California in particular, also have other consumer protection statutes that provide additional remedies to consumers.

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 Consumer Product Safety Act, a federal statute enforced by the Consumer Product Safety Commission (CPSC), requires manufacturers, importers, distributors and retailers of consumer products to notify the CPSC immediately if the company obtains information that reasonably supports the conclusion that a product distributed in commerce fails to

comply with an applicable consumer product safety rule, contains a defect that could create a substantial product hazard or creates an unreasonable risk of serious injury or death. Reporting a product issue does not automatically mean that the CPSC will conclude that the product creates a substantial product hazard or that corrective action is necessary. But if the CPSC or a court does reach that conclusion, the Act gives the CPSC and courts authority to order that a mandatory recall notice be issued by sellers.

The CPSC has a Recall Handbook that guides manufacturers, importers, distributors and retailers on reporting product defects and implementing safety recalls.

Other US government agencies that have the power to order product recalls are:

- the National Highway Traffic Safety Administration: cars, SUVs, trucks, motorcycles, tires, children's safety seats, etc;
- the Food and Drug Administration: food, pharmaceutical drugs, health supplements, beverages and cosmetics;
- the Environmental Protection Agency: pesticides, fertilisers, etc;
- the US Coast Guard: boats, watercraft, life jackets, etc; and
- the Federal Aviation Administration: aircraft.

A supplier and distributor can spell out in their distribution agreement which party is responsible for carrying out and bearing the cost of a recall.

Even if no mandatory recall scheme applies, the supplier and distributor of unsafe products may be subject to product liability lawsuits based on common law theories of negligence, breach of warranty or strict liability, or based on state product liability statutes.

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?

Article 2 of the Uniform Commercial Code (UCC) deals with transactions in goods and has been adopted, with various adjustments, in all states except Louisiana. Article 2 deals with both express warranties and implied warranties. Express warranties are affirmative statements (in the words of the UCC, an 'affirmation of fact or promise') by a seller to the buyer regarding the goods being sold. Specific words such as 'warrant' or 'guarantee' are not required to create express warranties. For example, product samples or the seller's description of the goods may create an express warranty if the description is part of the basis of the bargain (ie, the buyer is relying on the sample or statements in making the purchase).

Implied warranties automatically exist when products are sold, without the need for a specific affirmation. The implied warranty of merchantability is an assurance that the products are fit for the ordinary purposes for which such products are used. The implied warranty of fitness for a particular purpose arises if the seller has reason to know that the buyer intends to use the products for a particular purpose and that the buyer is relying on the seller's skill or judgment in selecting the products for that purpose.

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The UCC specifically allows sellers to disclaim both express and implied warranties on goods they sell, within certain limits. An express warranty must be expressly disclaimed; a disclaimer of the implied warranty of merchantability must specifically mention merchantability. Alternatively, a seller may disclaim all implied warranties by stating that the products are being sold 'as is' or 'with all faults', or by including some other phrase that makes it plain to the buyer there are no implied warranties. However, some states do not permit disclaimers of implied warranties for consumer products.

In addition to the UCC, the Magnuson-Moss Warranty Act, a federal statute, applies to express warranties on consumer products. The Act does not require any business to provide a written warranty, and it does not apply to warranties on products sold for resale or for commercial purposes. However, once a seller decides to offer a written warranty on a consumer product, the seller must comply with the Act by clearly disclosing the terms of the warranty and meeting other conditions. Violations are actionable both by the FTC and by injured consumers.

The Magnuson-Moss Act prohibits a seller who offers a written consumer product warranty from disclaiming or modifying state-law implied warranties. However, if the seller designates its written warranty as a limited warranty, the duration of implied warranties can be restricted to the same duration as the express warranty. And if a seller sells a product that carries a written warranty from the product manufacturer, but does not provide its own written warranty, the seller can disclaim the implied warranty, as long as the seller passes through the manufacturer's written warranty.

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 general, suppliers and distributors can exchange information regarding customers and end users without restriction as long as it does not include personal data about individuals. If it does include personal data, restrictions on exchange may apply, depending primarily on where the individuals reside. The California Consumer Privacy Act, which took effect on 1 January 2020, imposes comprehensive, EU-style (but even broader) requirements for the collection, use, processing, transfer and protection of personal data of California residents. In March 2021, Virginia became the second US state to enact comprehensive privacy legislation; it will take effect on 1 January 2023, the same day as the California Privacy Rights Act, a further expansion of the protections provided by the California Consumer Privacy Act. Other states are likely to follow.

At the federal level, the United States still lacks a privacy law of general applicability, despite ongoing efforts and legislative proposals. Federal legislation seems to be hung up on two issues: pre-emption of state privacy laws and private rights of action for violations. For now, federal privacy statutes remain confined to specific sectors such as banking, healthcare and credit reporting.

The FTC has been the chief federal agency on privacy policy and enforcement since the 1970s, when it began enforcing one of the first federal privacy laws – the Fair Credit Reporting Act. The FTC has a Division of Privacy and Identity Protection devoted to consumer privacy. In addition to its law enforcement work, the FTC conducts studies, holds workshops and issues reports on key tech-related topics. For example, the FTC has held an annual workshop called PrivacyCon, where scholars discuss recent research on privacy and security issues. The FTC also issues reports on specific topics, such as data brokers' practices and mobile security updating practices.

In general, the parties to a US distribution agreement can assign ownership of data as between themselves; for example, it is common for US franchise agreements to declare that the franchisor owns all data generated by the franchisee under its brand. But current and future state (and perhaps federal) privacy laws may supersede these contract provisions, at least with respect to personal data, by establishing that the individuals are themselves the owners of their own data.

If a distribution relationship involves the transfer of personal data of EU citizens to the United States, the transfer would, of course, be subject to EU law, in particular the General Data Protection Regulation (GDPR), which requires adequate protection for data transfers to the United States. The European Commission ruled in 2016 that the EU-US Privacy Shield programme provided adequate protection for such data transfers, but in July 2020, the Court of Justice of the European Union invalidated that ruling. As a result, the EU-US Privacy Shield Framework is no longer a valid mechanism to comply with EU data protection requirements when transferring personal data from the European Union to the United States. However, the European Data Protection Board and US government continue to work on alternative measures to ensure compliance with EU standards, such as Binding Corporate Rules and Standard Contractual Clauses. For updates, see https://www.privacyshield.gov/NewsEvents, a website maintained by the International Trade Administration of the US Department of Commerce.

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

If the customer data held by suppliers and their distribution partners includes personal data about individuals, they must take reasonable measures to protect the security of that data. The FTC has brought legal actions against organisations that have failed to maintain security for sensitive consumer information. In these cases, the FTC has charged the defendants with violating section 5 of the FTC Act, which bars unfair and deceptive acts and practices in or affecting commerce. Specifically, the FTC has alleged that the failure to employ reasonable security procedures was an 'unfair' practice (ie, one causing substantial injury, not reasonably avoidable by consumers, and not offset by benefits to consumers or competition). Not all security breaches are violations of FTC law, because a breach can occur even if security procedures were reasonable. But in the agency's view, businesses must continuously assess risks and make appropriate adjustments to their procedures.

When US privacy laws apply, they generally obligate businesses to take measures to safeguard against the risk of loss, damage, destruction of or unauthorised access to personal data.

According to the National Conference of State Legislatures (NCSL), all 50 US states, the District of Columbia, and the US territories of Guam, Puerto Rico and the Virgin Islands have enacted legislation requiring private or government entities to notify individuals of security breaches involving personally identifiable information. These laws typically specify who must comply with the law (eg, businesses, data or information brokers, or government entities); definitions of 'personal information' (eg, name combined with SSN, driver's licence or state ID, and account numbers); what constitutes a breach (eg, unauthorised acquisition of data); requirements for notice (eg, timing or method of notice and who must be notified); and exemptions (eg, for encrypted information). Links to the laws of each jurisdiction are available on the NCSL website.

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 and distributor may agree by contract that the supplier will have the right to approve the individuals who will handle the supplier's business. In general, the parties may also specify that the supplier's dissatisfaction with the management of its account constitutes grounds for termination of the contract. However, if a federal or state dealership law applies to the relationship, it is possible that the supplier's subjective dissatisfaction with management may not constitute good cause for termination under the statute.

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 in a typical arm's-length relationship. However, if the supplier dictates or exercises control over its distributor's employment practices, there is a risk, especially in California or a state with similar laws, that the supplier may expose itself to legal claims by government agencies and employees that the supplier is a 'joint employer' of the distributor's employees. A joint employer can be held liable for labour and employment law responsibilities to those employees.

The US has been embroiled for several years in a nationwide policy debate, at both the federal and state levels, regarding joint employer issues. For many years, the law was that Company A could not be deemed to be a joint employer of Company B's workers unless Company A exercised direct and immediate control over the essential terms and conditions of the workers' employment, such as hiring, firing, wages, benefits, scheduling, discipline, supervision and workplace safety. Although a fact-specific inquiry, the direct and immediate control standard created a fairly predictable legal regime for most businesses. Absent extraordinary circumstances, Company A would rarely be found to be a joint employer with Company B.

Beginning during the Obama administration, labour activists, unions, some franchisees, some employees, and some federal, state and local regulators undertook a major effort to loosen up the joint employer standard. Under the looser standard, a company may be considered a joint employer based on mere indirect or reserved control over the labour practices of another company. This change started with the National Labor Relations Board, which is responsible for enforcing the federal law protecting labour organising and collective bargaining activities, but it spread to other federal agencies with responsibility for wages-and-hours laws and workplace safety. In addition, the movement produced a spate of private litigation, including class action lawsuits, by workers alleging that businesses (franchisors in particular) should be deemed a joint employer.

There was a significant pushback against expanding joint employer liability. During the Trump administration, federal agencies changed direction back toward the old legal standard of joint employer. And in the franchise sector, about 18 states have adopted legislation to clarify that franchisors are not the employer of their franchisees or of their franchisees' employees. These state laws, however, only affect the states in which they were adopted. Early signs are that the Biden administration will reverse the federal policy direction yet again.

There are several steps that a supplier should take to reduce the risk of joint employer liability:

- the distribution agreement should state that the distributor has sole responsibility for all employment decisions and functions relating to its business, including recruiting, screening, hiring, firing, scheduling, training, compensation, benefits, wage and hour requirements, record-keeping, supervision, safety, security and discipline of employees, and that any information or technology tools provided by the supplier on those topics is purely advisory, not mandatory for the distributor;
- the distribution agreement should also require the distributor to inform all workers, before hiring and periodically thereafter, that the distributor, and not the supplier, is their employer and that the supplier does not assume and will not accept any employer, co-employer or joint employer obligations;
- the supplier should avoid dealing directly with employees below the distributor's owner or management level; and
- if it is necessary to provide training to the distributor's employees regarding the supplier's products or their installation or maintenance, the supplier should limit the training to product standards and avoid areas that are generic to any business.

Commission payments

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

The amount and timing of payment of commissions to a commercial agent generally are not regulated. However, many states have sales representative laws, which typically require the relationship between the supplier (principal) and the commercial agent (representative) to be in writing and to specify the method of computing commissions. More importantly, if the relationship is terminated, these laws protect the commissions earned by the agent prior to termination, by requiring payment within a specified time after termination. Commercial agents who do not receive the commissions due within the specified time may sue for

actual damages – double or triple damages in some states – plus attorneys' fees and litigation costs.

Good faith and fair dealing

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

In most states, the common law of contracts recognises an implied covenant of good faith and fair dealing in all contracts. However, some states still do not recognise a duty of good faith and fair dealing at common law, except in special circumstances. And even where the implied covenant is recognised, the courts generally will not entertain a claim for breach of the implied covenant independently of a breach of contract claim. In the words of one court, '[It] has no existence independent of the express terms of the contract, and cannot impose substantive duties or limit[s] on contracting parties beyond those in the specific terms of their agreements'.

A common judicial description of the implied covenant is that it 'imposes upon each party the duty to do nothing destructive of the other party's right to enjoy the fruits of the contract and to do everything that the contract presupposes they will do to accomplish its purpose'. A breach of the implied covenant can occur when one party unreasonably interferes with the justifiable expectations of the other party arising from the contract.

There are scores of cases under US law asserting claims for breach of the implied covenant of good fair and fair dealing. In the distribution context, these claims often have involved the supplier's or franchisor's termination of the relationship or its alleged direct or indirect encroachment on the distributor's or franchisee's territory. US courts have almost uniformly rejected these claims when the supplier's or franchisor's conduct was consistent with the express terms of the contract; as a general rule, the courts will not invoke the implied covenant to override express contract terms.

US courts are also reluctant to invoke the implied covenant of good faith and fair dealing if doing so would have the effect of creating rights that were not granted by contract. For example, in one case, the court held there was no breach of the implied covenant of good faith or fair dealing for delays in inventory delivery where the agreement contained no provision mandating certain delivery times and no standards for how a delay should be addressed. And, in particular, US courts generally will not invoke the implied covenant to establish territorial protection that was not agreed by contract.

In addition to the common law of contracts, the UCC imposes on sellers and buyers a general obligation of good faith, which requires both honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade. The UCC obligation of good faith may limit the ability of both parties to terminate their relationship, but, like the common law implied covenant of good faith and fair dealing, it will not override the express terms of a contract.

Specific industry statutes often incorporate good faith principles as well. For example, the Automobile Dealer's Day in Court Act, a federal law, permits an automobile dealer to sue

in federal court for damages caused by an automobile manufacturer's failure to act in good faith in terminating, cancelling or not renewing the dealership.

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?

US law does not require recordal or approval of distribution agreements or licence agreements for most products. (This response excludes industry-specific regulations, such as in the medical and agricultural sectors, that may apply to importation and distribution of products.)

Licensees of registered federal trademarks, US patents and US copyrights may, however, record licences at the US Patent & Trademark Office and US Copyright Office so as to put subsequent acquirers of the intellectual property on notice of the licensee's rights. Recordation can put parties on constructive notice of the facts stated in the recorded agreement. The records of the US Patent & Trademark Office and US Copyright Office are searchable online.

Anti-corruption rules

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

The principal US federal anti-bribery and anti-corruption law, the Foreign Corrupt Practices Act (FCPA), is directed at conduct toward other countries; the FCPA makes it illegal to offer or provide money or anything of value to officials of foreign governments or foreign political parties with the intent to obtain or retain business. However, the FCPA expressly applies to any person who violates the statute while in US territory.

Federal and state laws governing contracting with domestic government agencies, including the sale of products to those agencies, generally prohibit sellers from offering bribes, bid rigging and similar conduct. These laws would apply to distribution relationships on the same basis as to other contracts and relationships.

Section 2(c) of the Robinson-Patman Act, a federal antitrust statute, prohibits commercial bribery – ie, payments by a seller to an employee of a buyer to influence the buyer to purchase the seller's product. Secrecy is an essential element of this violation – payments that are disclosed to the buyer are not unlawful under this statutory provision.

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?

There is no US regulatory scheme applicable to distribution contracts as a general class. In most cases, parties are free to enter into a distribution relationship on whatever terms they choose, without any mandated terms or formalities or oversight by any government body. When special industry laws apply, however, the terms of those laws generally override contrary contract terms.

Under the common law of contracts in most US states, an implied covenant of good faith and fair dealing is deemed to inhere in all contracts. However, some states do not recognise a duty of good faith and fair dealing at common law, except in special circumstances. And even in states where the implied covenant is recognised, the courts generally will not invoke the implied covenant to override express contract terms.

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?

US courts typically honour the parties' choice of governing law in the contract as long as there is a substantial connection between the jurisdiction chosen and the parties or the subject matter of the distribution agreement. As an exception to the general rule, New York courts will respect a choice of law provision designating New York law as the governing law, even if neither the parties nor the subject matter of the contract bear any connection to New York state, as long as the agreement was made for, or contains an obligation involving, more than US$250,000.

US courts will decline to apply a foreign law if it violates a fundamental policy of the court's state. A US court may also decline to apply foreign law if it determines that the foreign law does not differ substantially from the local law.

If a distribution agreement is silent on what law applies, a US court will apply a conflicts of law analysis to determine which law to apply to the agreement. Courts in some states, like Florida and Virginia, apply the law of the jurisdiction where the contract was made. Courts in other states, like New York and California, apply the law of the jurisdiction with the most substantial connection to the agreement or the dispute.

The United States is a signatory of the United Nations Convention on the International Sale of Goods (CISG). If the contracting parties are from different countries that are both signatories to the CISG, a US court will often apply the CISG, even if the parties specify a different law, unless the parties expressly disclaim application of the CISG in the distribution agreement.

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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?

US courts typically honour the parties' choice of courts for resolving contractual disputes, if there is a legitimate connection between the jurisdiction chosen and the parties or the subject matter of the agreement. However, US courts may disregard (through the doctrine of forum non conveniens) a forum selection or arbitration clause in a particular case if the chosen forum is so inconvenient as to be unreasonable or is found to have been the product of fraud. And some states, either by statute or by court decisions, have limited the enforcement of forum selection clauses that would require their citizens to litigate in other states. These limitations tend to be in the context of laws protecting consumers or small businesses.

Mandatory arbitration clauses are widespread in the United States but have become somewhat controversial, particularly with respect to standardised consumer contracts and franchise agreements. There is a substantial amount of litigation involving parties seeking to avoid mandatory arbitration. However, the courts generally enforce arbitration clauses, and the Federal Arbitration Act (FAA) establishes a national policy in favour of doing so. Under the federal Constitution, the FAA generally pre-empts state laws that seek to restrict arbitration (eg, state franchise laws that prohibit designation of an arbitration venue outside of the state).

If a distribution agreement is silent on the selection of venue for the resolution of disputes, US courts may dismiss a claim brought by one of the parties if the court determines that it lacks personal jurisdiction over the defendant. These situations require a complex analysis of the connection between the defendant, the contract and the forum.

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 has not qualified to do business in a state is typically denied access to the courts until it files the qualification. Also, specific industry statutes may require certain disputes, such as a distributor or dealer claim for wrongful termination, to be resolved before government agencies or industry boards.

US courts can grant a wide array of remedies, including both damages and equitable remedies, particularly injunctive relief. However, US courts do not, as a matter of course, award attorneys' fees to the prevailing party, in the absence of a statute or contact provision that so requires.

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Foreign companies generally 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 sought to make themselves a desirable forum for dispute resolution by creating specialised commercial courts. Strategically, if a supplier believes it is more likely to be the party suing (eg, for non-payment of goods or perhaps for an injunction on IP matters), the supplier may wish to require lawsuits to be filed in a jurisdiction where the distributor holds assets to ease enforcement of a judgment awarded to the supplier.

Litigants have broad rights under US discovery rules to require disclosure of documents and deposition testimony. Electronic discovery of documents and email is also generally quite broad. This does substantially increase the cost of litigation in US courts. In response, some courts have taken steps to control costs by limiting the number and length of depositions and the number of interrogatories and by adopting rules that shift costs to the party seeking the discovery in certain circumstances. Increasingly, US courts require parties to engage in mediation of their disputes at some stage of the case in an effort to reach a settlement.

The parties may provide for alternative dispute resolution methods in their agreement, typically non-binding mediation or binding arbitration, or both. The Federal Arbitration Act (FAA) establishes a national policy in favour of enforcing agreements to arbitrate. 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. Accordingly, the rules and procedures agreed by the parties, such as the number and qualifications of the arbitrators, scope of discovery, and whether arbitrators may award punitive damages, will supersede contrary state law. While there is no similar statutory underpinning for non-binding mediation, a provision requiring mediation before parties proceed to court or binding arbitration generally will be enforced under principles of freedom of contract.

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?

US courts generally enforce agreements to mediate or arbitrate disputes. Although some state franchise laws prohibit designation of an arbitration venue outside of the state, the courts generally hold that these restrictions are pre-empted by the FAA, which establishes a national policy in favour of agreements to arbitrate. There are no general restrictions on non-binding mediation.

Mandatory arbitration clauses have become somewhat controversial, particularly with respect to standardised consumer contracts and franchise agreements, but they are widely used. There is much litigation by parties seeking to avoid mandatory arbitration. However, the courts generally reject these challenges absent unusual circumstances.

The chief advantage of arbitration for a foreign supplier is that the United States is a signatory of the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards. This means that an arbitration award rendered in favour of the foreign supplier in another

signatory jurisdiction generally will be enforceable in the US courts without relitigating the merits of the claim.

Other advantages and disadvantages of arbitration are the same as for other contractual relationships. Advantages include the ability of the parties to tailor the arbitration process to their needs by contract, the ability to select an expert decision-maker, the ability to designate the geographic location where the dispute will be heard, and (in theory at least) greater speed, lower cost and greater privacy than for litigation. The chief disadvantage is surrendering the opportunity to appeal an arbitrator's decision that the foreign supplier believes was clearly wrong.

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 United States is in the midst of a nationwide policy debate on worker classification and joint employer issues. The best exemplar is the independent contractor statute that took effect in California on 1 January 2020. The new law changed the standard for determining whether a worker is a legitimate contractor or a misclassified employee. The new standard makes it much harder to avoid the employee label and the resulting employer liabilities. The law is generally known as AB-5, its legislative bill number prior to passage, and it tracks a prior statute in Massachusetts.

AB-5 adopted the ABC test for determining whether a worker is an employee. Under the ABC test, a worker is presumed to be an employee – not an independent contractor – unless the hiring entity can show all of the following:

- the worker is free from control and direction of the hiring entity in the performance of the work, both under the contract and in fact;
- the worker performs work that is outside the usual course of the hiring entity's business; and
- the worker is customarily engaged in an independently established trade, occupation or business of the same nature as the work performed for the hiring entity.

The target of AB-5 was gig economy workers such as persons driving vehicles for companies like Uber and Lyft. These companies successfully fought for a referendum on the new law, and, in the autumn of 2020, California voters overturned application of the law to these companies. In the meantime, other businesses that use independent contractors, such as freelance writers, were successful in obtaining exemptions from the California legislature. However, other businesses have not received exemptions; in particular, franchise relationships have not been exempted. As written, AB-5 makes it extremely difficult for a franchisor to establish that its franchisees meet the test of an independent contractor, with the result that franchisees – the owners of independent franchised businesses – may be transformed against their will into employees in California.

The new administration of President Biden has made similar legislation a priority at the federal level. If the ABC test is adopted nationally, the legislation could have a severe impact on certain forms of distribution, franchising in particular.

In addition to worker classification rules, antitrust rules are currently under active review by US Congress, state legislatures, and federal and state competition agencies. The focus is to determine whether the business practices of major tech companies stifle the development of or competition with rival distribution channels. Specific proposals are only beginning to emerge, but new legislation could have a major impact on distribution of products through online platforms.

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