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International Sales Representative and Distributorship Agreements

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SPECIFIC CONTRACTUAL ARRANGEMENTS

International Sales Representative and Distributorship Agreements

by Jon R. Bauman*

I. Introduction

Frank Weil, the Assistant Secretary of Commerce for Industry and Trade, has stated that "[t]he next frontier lies beyond our borders—it is the world market and the countless opportunities that beckon to the bold and enterprising among us."[1] There is a great deal of room for expansion into the frontier of the world marketplace; only about eight percent of U.S. manufacturers carry on a steady export business.

If U.S. manufacturers are going to assault this frontier, it is important that U.S. businessmen and their lawyers understand the factors which influence U.S. exporting. A lawyer's role with respect to any transnational matter is not limited to a narrow, technical legal stance. When a U.S. attorney advises his U.S. exporter client, the attorney must push himself further and be in a position to advise the U.S. exporter as to how economic and political trends may affect his business and the international sales representation or distributorship contract that the U.S. attorney will write to protect him. Factors currently influencing U.S. exports include trade deficits, devaluation, economic slowdown and inflation.

A. Trade Deficits

The United States has been experiencing massive trade deficits in the last few years. Some experts are predicting that the trade deficit for 1978 will be close to $33 billion. Although 1978 exports have increased ten percent over 1977, imports have climbed by fifteen percent.[2] Neither economically nor politically can the U.S. government permit this trend

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[1] Weil, in 3 THE INTERNATIONAL ESSAYS FOR BUSINESS DECISION MAKERS 26 (M. Winchester ed. 1978).

[2] COM. AMERICA, July 13, 1978, at 2.

to continue. Although this seems to be a rather obvious conclusion, attempts have been made in Congress to erect barriers to exports. These barriers would prohibit the Export-Import Bank from extending financing to countries that engage in violations of human rights and would require environmental impact statements for Export-Import Bank financing of projects which are to take place outside the United States.[3]

B. Devaluation

The U.S. dollar has been declining steadily against such currencies as the German mark, the Japanese yen and the Swiss franc. At one point this year, the dollar had lost about thirty-four percent against the Swiss franc and about twenty-eight percent against the Japanese yen. These facts indicate that U.S. products will be cheaper for many foreigners, and this will probably result in an increase in U.S. exports. On the other hand, the cheaper dollar increases our import bill; the cost of Japanese steel and German automobiles will be higher even if we do not increase the number of units purchased, because it now takes more dollars to buy Japanese yen and German marks.

C. Economic Slowdown

The gloomy prediction of some experts at the Department of Commerce is that prospects for U.S. exports during the remainder of 1978 will be dampened because of the below average economic performance of most major industrial countries, which constitute our major markets abroad. The good news is that exports to most developing countries should expand rapidly, because those developing countries' commodity prices have increased substantially. Returning to the dark side, however, the Commerce Department thinks that sales to the oil exporting developing countries may be somewhat limited in the future because world oil surpluses have necessitated OPEC production cutbacks and lowered revenues.[4]

D. Inflation

United States internal inflation also causes prices to rise and, as a result, makes our products less competitive at home and abroad, even though the devalued dollar somewhat offsets this problem.

E. New Export Policy

Even though there may not always be a clear set of facts to light the way for U.S. exporters, President Carter's export policy declaration of

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[3] *See* 124 CONG. REC. E 2986 (daily ed. June 2, 1978) (remarks of Rep. Steers) for a discussion of human rights and the Export-Import Bank. For a discussion of the National Environmental Policy Act and the Export-Import Bank *see* CONG. REC. S 6518 (daily ed. April 27, 1978).

[4] COM. AMERICA, August 14, 1978, at 7.

September 26, 1978[5] offers some changes which will make it easier for U.S. exporters to cross the frontier. The areas affected by these changes include taxation, export financing, export development, antitrust law and government regulation.

In the taxation area, there has been continued opposition to Domestic International Sales Corporations ("DISCs"),[6] because they are too costly and inefficient. President Carter has promised to work with Congress to make DISCs "simpler, less costly and more effective."[7] As for export financing, more Export-Import Bank funds will be available and the credit terms will be eased. Export development programs at the State and Commerce Departments will be revitalized and expanded by providing more information and assistance to U.S. companies. Checks will be placed on the extraterritorial application of U.S. antitrust laws which needlessly impair U.S. ability to compete. Finally in the area of government regulation the President has promised a re-examination of the Foreign Corrupt Practices Act,[8] of environmental and safety regulations,[9] and of policies on transportation, investment and export controls in order to eliminate hindrances to competitiveness.[10]

Even if the attorney and the U.S. exporter client carefully analyze the political and economic climate for exporting and determine that the weather is favorable, there are always unexpected risks. This paper will identify risks and suggest solutions to some of the problems.

II. Nature of the Relationship

The two primary differences between a sales representative and a distributor relate to the identity of the purchaser and the method of compensation. Typically, a sales representative is a mere agent who receives a fixed commission. The sales representative does not take title to the products, and the U.S. exporter makes the sale directly to the buyer in the foreign country ("Territory"). A distributor purchases the products from the U.S. exporter and is compensated by his markup on the price of the goods sold to the ultimate buyer.

The U.S. Department of Commerce and major banks with extensive international contacts may be of assistance in locating a foreign sales representative or distributor.[11] Of course, the referrals given by the Commerce Department or by banks should be followed up by personal visits

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[5] United States Export Policy Statement by the President, 14 WEEKLY COMP. OF PRES. DOC. 1631 (Oct. 2, 1978).

[6] *See* text accompanying note 31 *infra*.

[7] *Supra* note 5, at 1633.

[8] Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1494 (1977).

[9] *See* National Environmental Policy Act of 1969, 42 U.S.C. § 4321 (1972), Air Pollution Prevention and Control, 42 U.S.C. § 1857 (1972), Public Works and Economic Development Act of 1965, 42 U.S.C. § 3121 (1972).

[10] *Supra* note 5, at 1634.

[11] *Commerce America* has listings of foreign private firms interested in agency and/or distributorship agreements on the final pages of every issue.

between the U.S. exporter and the foreign representative. It is impossible to emphasize too strongly the importance of picking the right foreign representative at the outset.

III. Particular Points of Local Law

It is desirable to stipulate in the contract that the law of a U.S. state will apply. However, even if the foreign representative agrees to this stipulation, numerous points of local law should also be examined. Local laws may be of importance as they apply to: termination of the contract; promissory notes; health, safety, labeling and testing requirements; exchange controls; import permits and documentation; product liability; and limited liability companies.

A. Termination

1. Termination for "Just Cause".— The agency laws of most countries stipulate that a principal may terminate an agency relationship at any time. However, in many countries, if the termination is not for "just cause", the agent has a right to indemnity for any damages sustained. Moreover, the labor laws of some countries require employers to pay certain amounts to employees who have been fired without "just cause" and in some cases provide that these rights of the foreign representative may not be waived in a private contract. In some extreme situations, a U.S. exporter may be prohibited from refusing to extend or renew a contract unless "just cause" exists.

2. Penalties.—In many instances, under either the agency law or labor law of a particular country, the penalty for terminating a contract without "just cause" can be substantial. Costa Rica has recently increased the penalty for cancellation to four months gross profits, based on an annual average, for each year of the contract's duration. Compensation to the foreign representative may also include expenses incurred in setting up the office and the cost of items purchased to operate the business.[12]

3. "Goodwill Indemnity".—In some countries, foreign representatives may be able to base their claim on an enhancement of goodwill theory.[13] Swiss and German laws provide for "goodwill indemnity", but this would not apply if a termination is for "just cause". Dutch law requires a "goodwill indemnity" payment irrespective of the cause of termination.[14]

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[12] Costa Rican Law No. 6209 of April 3, 1978. *See also* Proposed E.E.C. Directive regarding new agency law rules applicable to all nine E.E.C. member states, 6 J.O. COMM. EUR. (No. C 13) 2 (1977).

[13] [1977] DOING BUSINESS IN EUROPE - COMM. MKT. REP. (CCH) ¶ 23,291.

[14] *Id.* ¶ 30,949.

4. Partial Solutions.—Choosing the law of a U.S. state should be of some help to the U.S. exporter, but the laws of some foreign countries would void this provision and would require application of the Territory's law. There may be other methods of minimizing the risk. The U.S. exporter may claim the right to terminate on a year-by-year basis. The contract may specifically define "just cause", even though "just cause" is frequently spelled out in the applicable local law. The contract may set forth a "laundry list" of obligations of the foreign representative, including sales quotas which will be difficult to meet. It may state that the foreign representative is not an employee, agent or legal representative of the U.S. exporter. Last, the contract may provide that all enhancement in value of goodwill is for the sole benefit of the U.S. exporter. Another approach would be to permit the U.S. exporter to delay compensation payments to the foreign representative for several months, but this would probably be difficult to negotiate in most cases.[15]

B. Promissory Notes

If the U.S. exporter will be receiving promissory notes as payment for its products, a careful review of the applicable Territory law should be made. The laws of many countries contain peculiarities which, if not followed, can create problems regarding the validity or enforcement of payment on promissory notes. Mexican law, for instance, requires that the word *pagare* appear in the promissory note, and most conservative Mexican lawyers will advise their clients to have the entire text of the note prepared in both Spanish and English. It is also very desirable to have an *aval*,[16] which is, in effect, a third party guarantee of the promissory note. If there is an *aval*, obtaining a judgment in a Mexican court against the debtor is relatively simple. However, if there is no *aval*, years of delay in obtaining a judgment may be expected by the creditor.

C. Health, Safety, Labeling and Testing Requirements

Depending on the type of products the U.S. exporter is selling, one or more of these types of laws or regulations may apply. Typically, the easiest way to determine which requirements the U.S. exporter must meet is to have the foreign representative investigate the matter. However, if the U.S. exporter or the U.S. lawyer is not satisfied with the advice of the foreign representative, counsel in the Territory should be contacted.

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[15] COM. AMERICA, Sept. 25, 1978, at 6.

[16] *Aval.* "The guaranty of a bill of exchange; so called because it is usually placed at the foot or bottom (*aval*) of the bill." BLACK'S LAW DICTIONARY 171 (4th ed. rev. 1968). D.O., Aug. 27, 1932, as corrected in D.O., Sept. 8, 14 and 24, 1932, and Feb. 10, 1933; and amended: D.O., Aug. 31, 1933, Art. 933.

D. Exchange Controls

If a particular Territory has exchanged controls or if it appears that, due to economic stress, it may have to adopt exchange controls, the U.S. exporter may experience further difficulties. Exchange controls can take many forms, including prohibition of or restrictions on conversion or establishment of artificial conversion rates. The international departments of most of the larger banks will have information on whether exchange controls apply in a Territory.

E. Import Permits and Documentation

A U.S. lawyer will not normally be called on to deal with import permits and documentation. These matters are usually handled by a freight forwarder in the United States and a customs broker in the Territory. However, if the U.S. lawyer is asked to investigate, the foreign consulate of the Territory in many U.S. cities can sometimes furnish pertinent information, and if this fails, the embassy of the Territory in Washington, D.C. can be of assistance.

F. Product Liability

Many foreign countries do not have well-developed product liability laws. Therefore, the risk these laws may create is often minimal. In any event, a U.S. exporter should be advised to obtain appropriate coverage from an insurance broker with experience in the international arena.

G. Limited Liability Companies

The laws of most foreign countries provide for several types of limited liability companies in addition to corporations. A U.S. lawyer may be able to identify these companies as limited liability entities if they have some unusual lettering after the name of the company, such as "S.R.L." *(Sociedad de Responsibilidad Limitada)* or "GmbH" (*Gesellschaft mit beschrankter Haftung*). If a U.S. lawyer determines that a U.S. exporter is dealing with a limited liability company, the U.S. lawyer may wish to suggest that personal guarantees of the principals be given.

H. Miscellaneous

There may be many other items of local law which will be of importance to the U.S. exporter. For instance, if the foreign representative is unstable financially, the U.S. exporter may be concerned as to how it could protect its products against garnishment or attachment by third party creditors of the foreign representative. Furthermore, although many U.S. exporters do not like to go to the added expense, it is always desirable to have an attorney in the Territory review the contract. Rather than sending the contract to a local attorney with general instructions to review it and to comment on any problems he may see, it is preferable to send the contract to the local attorney with a specific list of questions to be answered.

IV. Particular Clauses

Many of the clauses in the contract will be similar to those used domestically. However, there are certain clauses which require special attention.

A. Force Majeure

The force majeure clause should be broadly drawn and should contain a list of items to be deemed force majeure which include, but are not limited to: fires; floods; riots; strikes; labor disputes; freight embargoes or transportation delays; shortages of labor; inability to secure fuel, materials, supplies or power at reasonable prices or because of shortages thereof; acts of God or the public enemy; any existing or future laws, regulations or acts of any federal, state or local government affecting the conduct of the U.S. exporter's business; or any other cause beyond the U.S. exporter's reasonable control.

B. Notice

Notice clauses should contain provisions for notice by mail, telex or telegraph. Notice should not be deemed completed until it is actually received by the party to whom it is addressed.

C. Designation of Territory

The foreign representative's Territory should be carefully defined. For example, if the Territory is to be Central America, each country to be included should be listed. Instead of saying the "southern half of France," each Department of France which is included should be specified.

D. Compensation and Currency

If the foreign representative's compensation will be a commission or a markup on products, this should be clearly set forth. If it is a commission, the basis upon which it will be computed should be established. If it is a markup, the amount of the markup and the person who will set pricing policies should be determined. Since there are many additional costs in an international transaction, it is desirable to stipulate who will pay for: freight, insurance, handling, crating and other shipping charges; import duties and permits in the Territory; costs and expenses of the foreign representative in his selling efforts; taxes (sales, value added, documentary, etc.) of the Territory; costs of complying with product testing, labeling, health and safety regulations of the Territory; costs of any specialized sales, engineering and marketing assistance and training; costs of translating brochures, price lists and other information into the language of the Territory; samples and stocks of spare parts; and service related to the products. The contract should also stipulate the currency in which payment to the U.S. exporter will be made. The currency is typically U.S. dollars.

E. Delivery

Any special delivery procedures should be specified. The point at which title will pass should be agreed on because this may be important with respect to U.S. or foreign taxes.

F. Uniform Commercial Code

If the law of a U.S. state is to apply to the contract, the applicable Uniform Commercial Code should be reviewed in order to assure that the U.S. exporter is given all possible protection.

G. Letters of Credit

If financing is provided by way of letters of credit, the forms to be used should be reviewed in order to assure that obstacles to payment of the U.S. exporter are reduced to a minimum. If possible, the letter of credit should be a "confirmed, irrevocable" letter of credit. Most letters of credit state that they are subject to the Uniform Customs and Practice for Documentary Credit ("Uniform Customs"). The Uniform Customs are issued by the U.S. Council of the International Chamber of Commerce, and copies may be obtained from the international departments of most major banks. Since the Uniform Customs were prepared in large part by bankers, they are weighted in favor of the banks. Thus, if the letter of credit and the procedures followed pursuant thereto do not specifically comply with the Uniform Customs, the banks, in some cases, have the right to delay or withhold payment.

H. Assignments

The foreign representative's right to assign all or part of the contract should be specifically denied. If this is not done, it is very possible that the foreign representative's incompetent brother-in-law will be attempting to sell the U.S. exporter's products in a portion of the Territory.

I. Technical Products

When the contract involves technical or highly engineered products which require specialized selling, engineering or servicing techniques, the contract should specify which portions thereof the U.S. exporter will provide and which the foreign representative will provide, and who will pay for those items.

J. Taxes

The following clause may be utilized as a starting point, but should be tailored to the necessities dictated by each Territory:

> The Foreign Representative agrees to discharge and to hold the U.S. exporter harmless on account of any taxes or governmental charges (including income taxes, customs duties, value added taxes, documentary taxes, and sales, use and turnover taxes) of the government of the Territory which may be imposed with respect to the execution and delivery of this contract, any sales or other transactions hereunder or any income earned or payments received by the U.S. exporter hereunder. In the event the foreign representative is required to withhold or pay taxes on payments to the U.S. exporter, the foreign representative will promptly thereafter furnish the U.S. exporter with funds in the full amount of the sum withheld.

K. Default

In order to permit the U.S. exporter to terminate the contract as easily as possible, the default clause should be very carefully drawn. The default clause should state that any termination under its provisons will be deemed to be "just cause" for terminating the contract. Also, upon termination, the parties should provide for the handling of products which are in the hands of the foreign representative; the disposition of signs, displays and advertising materials; products which have been ordered but not yet delivered; and other related matters.

V. U.S. Export Control Laws

United States export control laws are designed to protect national security, prevent the export of scarce materials for economic and military reasons and to further U.S. foreign policy. Many products will not be regulated by the U.S. export control laws. However, if the U.S. exporter's products or the Territories to which the products are moving appear to fall within the general guidelines set forth herein, applicable laws should be reviewed.

There are four major U.S. export control laws. The Trading with the Enemy Act[17] generally prohibits any trade with an enemy of or ally of an enemy of the United States, except with the license of the President. An enemy is any country with which the United States is at war or any country that the President designates as an enemy. Regulations issued under the Act are the Foreign Assets Control Regulations,[18] the Transaction Control Regulations[19] and the Cuban Assets Control Regulations.[20] Prior to 1969, the Export Administration Act[21] required that many products which were to be shipped or transshipped to communist

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[17] 50 U.S.C. §§ 1-44 (1917).
[18] 31 C.F.R. §§ 500.101-500.809 (1977).
[19] 31 C.F.R. §§ 505.01-515.809 (1977).
[20] 31 C.F.R. §§ 515.101-515.809 (1977).
[21] 50 U.S.C. §§ 2401-2406 (1969).

block countries had to be shipped under export licenses. However, the amended Export Administration Act relaxes this posture and export licenses are no longer required in many instances. The Mutual Defense Act[22] permits the U.S. government to embargo shipments of arms, ammunition, implements of war, atomic energy materials, petroleum and other similar strategic items to nations which threaten the security of the United States. The International Traffic in Arms Regulations ("ITAR")[23] were issued in 1972 pursuant to the Mutual Security Act.[24] ITAR gives the President authority to control the import and export of arms, ammunition and implements of war, including technical data related thereto.

Controls on exports may also be effected by the Export-Import Bank which has, from time to time, refused to extend financing to projects in communist and certain other countries. The U.S. exporter, if using Export-Import Bank financing, should check with the Bank to determine whether financing is available for the Territory.

VI. Patents and Trademarks

A. Contract Provisions

If the U.S. exporter has valuable patents, trademarks, trade names, commercial names, service marks or trade secrets ("Industrial Property"), the contract with the foreign representative should contain adequate protective language for the U.S. exporter. Such language should contain the following statements. The foreign representative will not market the U.S. exporter's products except under its name or trademarks. All advertising and brochures will contain the latest patent numbers and patent pending information specified by the U.S. exporter. The foreign representative must expressly acknowledge and agree that all Industrial Property is the exclusive property of the U.S. exporter, and that the foreign representative will have no right, title or interest therein, nor to any goodwill related thereto, before, during or after the term of the contract. The foreign representative's enhancement in value of any Industrial Property, or any goodwill related thereto, in the Territory or elsewhere, shall be for the sole benefit of the U.S. exporter. The foreign representative will immediately notify the U.S. exporter of any pirating, infringement or imitation of any Industrial Property owned by the U.S. exporter. Either the U.S. exporter or the foreign representative will control any litigation and will pay for such litigation.

B. Registration

In many cases, the U.S. lawyer may wish to recommend to the U.S.

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[22] 22 U.S.C. §§ 1611-1613 (1951).
[23] 22 C.F.R. §§ 121.01-121.22 (1972).
[24] 22 U.S.C. §§ 1750-1951 (1954).

exporter that it register its Industrial Property in the Territory. All countries have lawyers who specialize in Industrial Property matters, and they are generally competent to attend to Industrial Property registrations. Lawyers who specialize in patent or trademark law will generally have a directory or list of the names of foreign attorneys who specialize in this type of work.

C. Less Developed Countries

In many countries, particularly the less developed countries, restrictions on the transfer of technology are a very sensitive issue. Many third world countries claim that the industrialized nations have conspired to keep technology under their control and to keep the underdeveloped countries in that posture by denying them access to modern technology. Mexico, for example, in 1973, incorporated this thinking into its Law on Registry of Transfer of Technology and Use and Exploitation of Patents and Trademarks ("Technology Law").[25] Under the Technology Law, a contract must be registered with the appropriate Mexican governmental agency within sixty days after execution if the contract: (a) Grants the use of or authorization to exploit trademarks, patents, industrial models or blueprints; (b) Supplies technical know-how by blueprints, diagrams, models, instructions, formulae, specifications, or preparation and training of personnel; (c) Provides basic or detailed engineering to install plants or manufacture products; (d) Renders technical or operational services. Failure to register makes the contract ineffective and unenforceable under Mexican law.

Registration under the Technology Law will be denied if the contract contains clauses which provide: (a) Excessive compensation in regard to the technology acquired or an unjust burden on the national economy; (b) The licensor of technology is permitted to direct or intervene in the administration of the licensee; (c) The licensee of the technology is required to assign patents, trademarks, innovations or improvements obtained by the licensee to the licensor; (d) The technological investigation or development of the licensee is limited; (e) The licensee must acquire equipment, tools, parts of raw materials exclusively from a specific source; (f) The export of goods or services produced by the licensee is prohibited or limited contrary to national interests; (g) The licensee is required to enter into an exclusive sales or representation contract in Mexico with the licensor; or (h) The contract is subject to interpretation in foreign courts. There are other prohibitions contained in the Technology Law, and if the U.S. exporter is doing business in Mexico or with any other country which may have a similar law, the law should be carefully reviewed.

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[25] Mexican Registration Law of Transfer of Technology and the Use and Exploitation of Patents and Trademarks, D.O., Dec. 30, 1972, *reprinted in* 12 INT'L LEGAL MATERIALS 421 (1973).

VII. Boycotts

Each of the twenty members of the Arab League has adopted the Unified Law on the Boycott of Israel[26] which prohibits commercial dealings with Israel. All persons in member Arab states are barred from concluding agreements or transactions with persons or organizations situated in Israel, affiliated with Israel through nationality or working for or on behalf of Israel, regardless of place of business or residence. No Israeli goods or goods containing Israeli components may be imported into any member Arab state. Member Arab states may not do business with foreign companies having offices, branches or general agencies in Israel. The transshipment of goods bound for Israel through member Arab states is prohibited. Doing business with companies whose names are on the blacklist maintained by the Central Boycott Office is also barred. Companies may be put on the blacklist because they permit their trademarks or patents to be used in Israel, or they engage in financing major projects in Israel or in selling Israeli bonds, or they own or use ships that call at Arab and Israeli ports on the same voyage. The Unified Law on the Boycott of Israel also requires companies wishing to do business in Arab countries to be certified and to pledge to comply with that law.

The U.S. reacted to the Arab boycott by adopting "anti-boycott laws" in the guise of tax laws and Export Administration Regulations. Tax sanctions are found in sections 908, 952, 995 and 999 of the Internal Revenue Code.[27] Under those laws, if a U.S. exporter participates in or cooperates with an international boycott, it will receive unfavorable treatment under the provisions related to tax credits, Sub-part F and DISC. Pursuant to the Export Administration Act,[28] regulations have been adopted requiring that "all domestic (U.S.) concerns receiving requests [to comply with a boycott] must report this fact to the Secretary of Commerce. All [U.S. exporters] are prohibited from taking any action, including the furnishing of information or signing of agreements, that has the effect of furthering or supporting a restrictive trade practice . . . or has the effect of discriminating against U.S. citizens or firms on the basis of race, color, religion, sex or national origin."[29]

VIII. Taxes

Taxes are particularly important with respect to export sales because they directly affect the U.S. exporter's pricing, profits and ability to penetrate the market in a Territory.

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26 League of Arab States, Resolution No. 849 (Dec. 11, 1954). Cited and discussed in H. HASSOUNA, THE LEAGUE OF ARAB STATES AND REGIONAL DISPUTES 270-71, 467-83 (1975).

27 I.R.C. §§ 908, 952, 995, 999.

28 Export Administration Act, *supra* note 20.

29 15 C.F.R. §§ 369.1, 369.2.

A. Tax Treaties

In drafting the contract, care must be taken to assure that the U.S. exporter does not derive business profits from a "permanent establishment" in the Territory which would subject the U.S. exporter to income taxes of the Territory. A typical definition of "permanent establishment" is found in the United States-United Kingdom Tax Treaty.[30] The United States is a party to income tax treaties with many nations throughout the world.

By the use of skillfully written contract provisions, it is usually relatively easy to protect a U.S. exporter, who merely sells goods through a foreign representative in a Territory with which the United States has a tax treaty, from the obligation to pay income taxes in that Territory. In order to assure this result, it will be necessary to include language in the contract to the effect that the foreign representative shall have no authority to conclude contracts or extend warranties on behalf of the U.S. exporter and that the foreign representative is an independent contractor, and is not a partner, co-venturer, agent, employee or legal representative of the U.S. exporter, and is acting in the ordinary course of its business. The applicable tax treaty should be consulted in each instance.

When the U.S. exporter is dealing with a Territory which has no income tax treaty with the United States, these same provisions should be included in the contract. The U.S. lawyer should also have an attorney in the Territory confirm in fact that the U.S. exporter will not be liable for local income taxes, especially if a substantial amount of money is involved.

B. Domestic International Sales Corporations

The legislation regarding Domestic International Sales Corporations ("DISC") was adopted in 1971 and is contained in sections 991 through 999 of the Internal Revenue Code.[31] Many foreign governments allege that DISCs are export subsidies and have pressured the U.S. government to eliminate DISCs. Some domestic lobbying groups are also attempting to quash DISCs. There have been numerous newspaper articles recently which indicate that the Treasury Department is considering the elimination or limitation of DISCs, and Secretary Blumenthal has indicated that this is the case. However, DISCs still exist and can be of benefit to U.S. exporters for at least the near term.

The problem created by DISC is the difficulty of administering them, both from a legal and practical standpoint. The legislation was originally designed to make it easy for U.S. exporters to qualify as and

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[30] Income Tax Treaty Between the United Kingdom and the United States, ¶ 8103E (1975), TAX TREATIES (CCH). "Permanent establishment" is defined by ¶ 8103E (1) as "a fixed place of business through which the business of an enterprise is wholly or partly carried on."

[31] I.R.C. §§ 991-999.

utilize DISCs. However, after extensive lobbying by many groups the DISC legislation turned into a tax lawyer's dream and a layman's nightmare. Therefore, unless substantial export sales are involved, the administration of DISCs may be so costly and cumbersome that it is not economically feasible for a small U.S. exporter.

C. Free Trade Zones

Some countries, such as Panama and Singapore, have created free trade zones. If a U.S. exporter has special needs, it could ship its products to a zone without paying customs duties or income taxes and either process the products further or store them for shipment at a later date.

D. Territory Taxes

1. Income Taxes.—If an income tax treaty applies and the U.S. exporter complies therewith, there should be no problem with Territory taxes. However, U.S. exporters should be urged to contact local counsel in those Territories where there is no income tax treaty. Also, a U.S. exporter may be further protected by inserting a clause in the contract stating that the foreign representative will be liable to pay, and to reimburse the U.S. exporter for, any taxes of the Territory.

2. Customs Duties.—The contract should obligate the foreign representative to pay customs duties of the Territory which apply to the U.S. exporter's products. Typically, the cost is ultimately passed on to the customer via higher prices. However, when price competitiveness is a vital factor in making sales, obtaining the most favorable customs duty treatment can be very important.

Many countries, although not the United States, use the Brussels Tariff Numbers[32] to categorize particular products. On occasion, there may be more than one Brussels Tariff Number which will apply to the U.S. exporter's product, and one number may carry a lower duty rate than another. Therefore, it is sometimes advantageous for the U.S. exporter to determine the applicable Brussels Tariff Numbers and to attempt to have the product categorized under the most favorable Brussels Tariff Number.

3. Other Local Taxes.—In many countries, a value added tax or a sales or gross receipts tax will apply. Also, some countries have small taxes, such as documentary, stamp and other similar taxes. Usually, the foreign representative will be able to determine the amount of these taxes and advise the U.S. exporter as to how much they will be. In any event, the foreign representative should be obligated by the contract to pay the Territory taxes.[33]

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32 Brussels Tariff Numbers are available upon request from the Dep't of Commerce, Commerce Building, Washington, D.C. 20230.

33 A U.S. exporter may need to consider another tax aspect as well. Beginning in 1976,

IX. Antitrust Law

U.S. exporters must comply with applicable U.S. and foreign antitrust laws in their contracts.

A. United States

United States antitrust laws are, generally, a "never-never land" into which a non-expert should not venture. Therefore, it is usually wiser to associate an antitrust expert if there appear to be problems in this area. The *Antitrust Guide for International Operations*,[34] published by the U.S. Department of Justice, is a useful outline of some of the more common types of antitrust problems.

B. European Economic Community

In addition to the antitrust or antimonopoly laws of each EEC country, the Treaty of Rome,[35] in Articles 85 and 86, establishes a Community-wide antitrust law. The Treaty of Rome prohibits agreements "which have as their object or result the prevention, restriction or distortion of competition within the Common Market." Article 85 specifically prohibits practices which include: direct or indirect fixing of purchase or selling prices or of any other trading conditions; the limitation or control of production, markets, technical development or investments; market sharing or the sharing of sources of supply; the application to parties to transactions of unequal terms in respect of equivalent supplies, thereby placing them at a competitive disadvantage; making the conclusion of a contract dependent on the acceptance by a party of additional supplies which, either by their nature or according to commercial usage, have no connection with the subject of the contract.

The enforcement body for the Treaty of Rome is the EEC Commission, an administrative agency which is generally similar to the U.S. Federal Trade Commission. Orders of the EEC Commission can be appealed to the High Court of Justice, and some observers feel that the High Court of Justice will readily overrule the EEC Commission. In contrast, the U.S. Supreme Court frequently affirms FTC decisions.

EEC antitrust law is not as severe as U.S. law in that all penalties are civil, and corporate officers cannot be fined or sent to jail. There is also no provision for private treble damage actions as there is under U.S. law. If the U.S. lawyer believes that the U.S. exporter's contract may

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the Western Hemisphere Trade Corporation ("WHTC") benefits were reduced and, for taxable years beginning after December 31, 1979, the WHTC provisions are repealed.

34 U.S. DEP'T OF JUSTICE, ANTITRUST GUIDE FOR INTERNATIONAL OPERATIONS (1977).

35 Treaty Establishing the European Economic Community, 298 U.N.T.S. 11. *See also* EUROPEAN COMMUNITY INFORMATION SERVICE, ARTICLES 85 AND 86 OF THE EEC TREATY AND THE RELEVANT REGULATIONS: A MANUAL FOR FIRMS, DOC. 8062/5/IX/1962/5; and A. DERINGER, SOME PRACTICAL ASPECTS OF THE ANTITRUST PROVISIONS OF THE TREATY OF ROME (1962).

violate the provisions of the EEC antitrust law, there is a procedure for obtaining a prior ruling from the EEC Commission.

C. Other Nations

Many countries, including each of the EEC countries, have an antimonopoly or antitrust law. Most of these laws are phrased in vague and general language. The flavor of these laws is seen in Article 196 of the Philippines Penal Code which makes it unlawful for any person:

> To enter into any contract or agreement or take part in any conspiracy or combination in the form of a trust or otherwise, in restraint of trade or commerce or to prevent by artificial means free competition in the market; to monopolize any merchandise or object of trade or commerce, or combine with any other person or persons to monopolize said merchandise or object in order to alter the prices thereof by spreading false rumors or making use of any other artifice to restrain free competition in the market; being a manufacturer, or producer or processor of any merchandise or object of commerce or an importer of any merchandise or object of commerce from any foreign country, either as principal or agent, wholesaler or retailer, to combine in any manner with other persons for the purpose of making transactions prejudicial to lawful commerce or of increasing the market price in any part of the Philippines of any such merchandise manufactured in or imported into the Philippines, or of any article in the manufacture of which such manufactured or imported merchandise is used.[36]

The only positive thing that may be said for these laws is that, particularly in the less sophisticated countries, they do not seem to be enforced with much vigor.

X. Foreign Corrupt Practices Act

By a 1977 amendment[37] to the Securities Exchange Act of 1934 ("Act"),[38] Congress prohibited, directly or indirectly through an intermediary, the bribery of certain foreign officials or foreign political parties, party officials or candidates for public office for the purpose of (a) influencing any action, inaction or decision by such a person in his or its official capacity or (b) inducing such a person to use his influence with a foreign government or an instrumentality thereof to affect or influence any act or decision of such government or instrumentality, in order to assist in obtaining or retaining business for a domestic concern or in directing business to a domestic concern. The prohibition applies to U.S. citizens or residents, and to business entities which have their principal place of business in the United States or are organized under the laws of a U.S. state, territory, possession or commonwealth. Corporations or other business entities convicted of violating the Act are subject to fines ranging up to $1,000,000. Individuals, including corporate directors and officers, are subject to fines up to $10,000 and imprisonment for up to

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36 Philippine Penal Code art., 196 (Phil. 1970).

37 Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, § 201, 91 Stat. 1498 (1977).

38 15 U.S.C. § 78 (1971).

five years, or both, for willful violations of the Act. There are also record keeping and accounting control requirements which apply to "issuers" under the Act. Issuers are companies with securities registered under Section 12 of the Act or companies required to file reports under Section 15(d) of the Act.

XI. Conclusion

Despite the foregoing catalogue of legal problems, it appears that the U.S. government, for political and economic reasons, will take steps to encourage U.S. manufacturers to increase exports. Therefore, it is very possible that many U.S. attorneys will soon be drafting international contracts. It is hoped that this paper will help eliminate some of the risks the U.S. exporter client faces when it crosses into the frontier of the world market place.

Question and Answer

Question: Are there any reasons why parts replacement and maintenance service should be handled differently than a typical sales arrangement?

Mr. Bauman: No, except in the service area where the additional factors involved add to the complexity of the transaction. For instance, will the foreign representative do the servicing or will it be done in the United States? On what basis is the foreign representative to be compensated for the service performed? Other than the additional logistical and economic problems, maintenance service and parts replacement are just like exporting goods.

Question: Suppose that a U.S. company has a foreign distributor, which in turn has subdistributors. What is the obligation of the U.S. company when the distributor terminates its relationship with a subdistributor for just cause?

Mr. Bauman: Unless the law of the particular country provides for it, in this situation there is no contractual relationship between the U.S. company and the subdistributor. To be sure about local law, I would advise consulting a local attorney. Without a contractual relationship there is no obligation here on the part of the U.S. company. I like to control as much of the chain of distribution as possible, so I always include a clause providing that any subdistributorship, agency agreement, etc. which the distributor enters must be in writing and must be approved by me and by my client. Sometimes we prepare a form agreement and have all subdistributors sign it.

Question: The President's trade message of September seemed to say that U.S. companies should not forego business out of fear of prosecution under the Foreign Corrupt Practices Act. Please comment.

Mr. Bauman: I would not interpret his statement that way. I think the government is going to reexamine the Foreign Corrupt Practices Act and other legislation which is supposedly detrimental to U.S. exporting efforts. However, I would not depend on this legislation being weakened on the basis of President Carter's remarks.

Question: What problems should U.S. exporters be aware of when drafting sales agreements with foreign governments?

Mr. Bauman: The sovereign immunity issue is the greatest problem. The best solution is to have an irrevocable letter of credit or to be paid in advance, because if the government should refuse to pay, the exporter has little if any recourse. If you must sell on credit, mark the price up to offset this risk.