

International Transactional Issues -- Traps for the Unwary

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Structuring, Negotiating & Implementing Strategic
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Overview

- Identify 15 recurring problems which arise in negotiating various agreements included in a typical international strategic alliance
 - These issues are uniquely international, and do not arise in domestic transactions
- Two Case Studies:
 - European Union – block exemptions and directives which affect key alliance agreements
 - Southeast Asia – recurring problems faced by U.S. companies, from a foreign attorney's perspective

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Recurring International Contractual Issues

- top 15 list (+ 1) of recurring issues faced when negotiating international strategic alliance agreements
- premise: even experienced negotiators will face issues which are uniquely international, and with which they may not be familiar
- to make these points a bit easier to remember -- movie references

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#15 - Negotiating Strategies

- “Everyone dances to the beat of a different drummer”
- foreign party is a product of its own national business culture
- your negotiating strategy should be adjusted, depending on which business culture you are facing
 - Those differences go well beyond regional differences or the personality quirks which may arise in domestic negotiations

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#14 - Payment Issues

- “Show me the money!”
- foreign exchange fluctuations
 - Euro may lessen problems between some EU countries, but may actually increase problems for US companies
- foreign exchange controls
- in most cases, lack of security interest
- don’t be afraid to ask for letters of credit
- watch out for force majeure clauses

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#13 - Legal Opinions and Insurance

- “Insurance, we don’t got no stinkin’ insurance”
- for the most part, legal opinions and insurance requirements are relied upon much less often outside the United States, and may be far less reliable
- bridge the gap -- you will have to do more due diligence yourself

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#12 - Number of Pages of Agreement

- “Frankly Scarlet, I don’t give a damn”
- in many countries, agreements are catching up (or even surpassing) U.S. agreements in length
- better to insist on more pages than to give up legal protections (depending which side you are on)
- single-space, 10 pt. type

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#11 - Illegal Activities

- “We’re not in Kansas any more , Toto”
- Not everyone does it
- You may be held accountable in the United States, even if the behavior is legal (or at least tolerated) in the foreign country
 - Foreign Corrupt Practices Act
 - Extraterritorial reach of U.S. antitrust laws
- Examples of typical contractual clauses: resistance by non-U.S. party should be a red flag
 - operate in compliance with applicable law
 - export compliance
 - responsibility for taxes
 - Foreign Corrupt Practices Act

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#10 - Foreign Attorneys

- *Fill in your own lawyer joke* (universal)
- Approaches to lawyering differ outside U.S.
 - beyond a few English-speaking countries, far less specialization into practice areas
 - you want business suggestions, not just professorial pronouncements
- Finding foreign counsel
 - relying on directory listings is not enough
 - conflicts rules differ
- Highlight the key questions
- Ask for an estimate of fees in advance
- Set a realistic deadline for their response
- TRAP – the unidentified in-house attorney

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#9 - Taxes

- “They’ll catch you coming and they’ll catch you going”
- Special international tax issues, three of which do not arise in domestic transactions
- (1) permanent establishments: “trading in” vs. “trading with”
- (2) transfer pricing
- (3) withholding taxes on royalty income
- (4) “gross-up” provisions

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#8 - Non-Competition Covenants; Grant-Back Provisions

- “How are you going to keep them down on the farm after they’ve seen Paris?”
- Enforcement problems
 - remedies against breaching party
 - sanctions for trying to impose unfair conditions
- Foreign antitrust laws are targeted against “restraints of trade” imposed by “big foreign companies” abusing their market positions

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#7 - Government Approvals and Registrations

- “They like to watch”
- Greater number of approvals than in U.S., both in number and varieties
- More on-going role of foreign regulators
- Key -- identify these issues early on
 - don’t give the other side an opportunity to renegotiate, based on its government’s requirements
 - shift regulatory costs to other side

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#6 - European Economic Area

- “Things are getting curiouser and curiouser”
- European Union (15) vs. European Economic Area (15 + Norway, Iceland and Liechtenstein)
- European regulators play a more active role than U.S. antitrust authorities (come to us to see if it is O.K.)
- Many standard U.S. practices cause problems
 - Territorial limitations
 - Sharing information on retail pricing
 - Non-competition covenants
- Key: unified market for goods and services

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#5 - Termination

- “Parting IS such sweet sorrow ” (for you)
- Compensation due upon termination of relationship
- Compensation due upon refusal to renew
- In some circumstances (e.g., employees, sales representatives in European Economic Area), cannot be waived contractually

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#4 - Territoriality of Intellectual Property

- “Taking the show on the road isn’t always easy”
- U.S. patent and trademark registrations are only effective vs. making, using and selling in the United States
- Key traps for the unwary:
 - PCT filings: predicting where you might want protection years into the future
 - avoid being blackmailed by your own trademark
 - protect your URL address

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#3 - Dispute Resolution

- “Damn the litigators, full speed ahead . . . to arbitration”
- Ease of enforcement (with some exceptions)
- More acceptable to foreign party
 - private
 - perceived as an even-playing field
- Flexibility on location and rules
- Solomon problem – splitting the baby
- Key: preserve right to seek injunctive relief

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#2 - Effect of Non-Governing Laws

- “Me and my shadow”
- Choosing governing law is not the end of the analysis
- You still may be affected by foreign tax, antitrust, consumer protection and other laws
- Will your choice of law be respected at all?

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#1 - Choice of Law

- “There’s no place like home, there’s no place like home”
- Avoid statutory warranties
- Enforce limitations on liability
- Avoid extra procedural steps to termination
- Avoid post-termination compensation
- Avoid administrative confusion between your various contracts

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+1

- NEVER, NEVER, NEVER TRY TO NEGOTIATE OR DRAFT IN ANY LANGUAGE OTHER THAN ENGLISH
- Other side is probably used to dealing in English
- That does not mean that you need to be “polite” and try to deal in their language

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CASE STUDY #1 European Economic Area

- Block Exemption for Vertical Agreements
- Commercial Agency Directive
- Block Exemption for Technology Transfer Agreements
- Block Exemption for R&D Agreements
- Block Exemption for Specialization Agreements
- Guidelines for Horizontal Cooperation Agreements
- Data Protection Directive

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Block Exemptions and Directives

- Article 81(1) general rule
 - agreements are prohibited if they affect trade between Member States of the European Union and have as their object or effect the prevention, restriction or distortion of competition
- Article 81(2): void agreements
 - offending provisions prohibited under Article 81(1) are automatically void.
- Article 81(3): exemptions
 - protects an agreement if and to the extent that the benefits of the agreement outweigh the resulting harm to competition
 - Case-by-case: individual exemptions
 - By rule:
 - Block exemptions
 - De Minimis rule
- Compared vs. Directive: Adopted by European Parliament and Council, and must be implemented into national legislation of 15 EU Member States

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Block Exemption for Vertical Agreements

- Affects distribution, purchasing, OEM, franchise and service agreements
- Most common issues:
 - grants of exclusive rights
 - non-competition covenants (up to 5 years)
 - territorial restrictions (active vs. passive sales)
 - setting minimum resale price (but maximum price is OK)
- Safe harbor is not available if:
 - supplier's market share exceeds 30%
 - for exclusive supply arrangements, buyer's market share exceeds 30%

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Commercial Agency Directive

- Definition of commercial agent most likely applies to sales representatives, manufacturers representatives and other intermediaries who receive commissions
- Specific requirements imposed by Directive
 - commission due before principal is paid – when transaction is executed (e.g., upon shipment) (Article 10)
 - commissions payable for transactions concluded after termination, under certain circumstances (Articles 7, 8 and 9)
 - principal has certain minimum obligations (Article 4)
 - required notice periods for termination (Article 15)

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Commercial Agency Directive – Post-Termination Indemnity or Compensation

- Terminated commercial agent entitled to an indemnity or compensation (Article 17)
 - cannot be waived by contract (e.g., choice of law)
 - applies to both terminations and refusals to renew, if without good cause
- Steps to avoid indemnity/compensation
 - make sure termination/refusal to renew is based on good cause (e.g., failure to meet minimum)
 - appoint sales representative on a non-exclusive basis

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Block Exemption for Technology Transfer Agreements

- Block exemption is applicable to patent licenses, know-how licenses and mixed patent and know-how licenses
 - not applicable to licenses for trademarks, copyrights or mask work rights, unless ancillary
- Exclusive or semi-exclusive license agreements for intellectual property may have Article 81(1) problems
 - exclusivity limited to length of patent right or 10 years from first sale (if know-how license)
 - same time period on territorial restrictions
- White list (Articles 1 and 2), black list (Art. 3), grey clauses (Art. 4) and relationship to underlying IP right
 - non-competition covenants are on black list, but licensor can reserve right to convert licensee to non-exclusive rights and to stop licensing improvements if licensee begins competing

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Block Exemption for Technology Transfer Agreements

- Block exemption does not protect:
 - license agreements in connection with joint ventures
 - software licenses
 - field of use restrictions which are regarded as customer selection (e.g., where field is defined by classes of users, forms of distribution, type of packaging)
- In EU territories in which licensed rights are not protected by parallel intellectual property rights, neither passive nor active sales can be restricted
- European Commission can withdraw protection where an agreement has certain effects on competition that cannot be justified under Article 81(3)
 - where the licensee's market share exceeds 40%

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Block Exemption for R&D Agreements

- Covers joint R&D efforts, as well as joint exploitation of the results of those efforts
 - as an alternative to joint exploitation, can restrict exploitation by a party to a particular field(s), so long as the parties were not competitors at the time of the agreement
- moves away from clause-based analysis: white, black and grey
- Below 25% market share threshold, all agreements are exempt, but for “hardcore” restrictions
 - restrictions on carrying on R&D with third parties in other fields
 - price-fixing

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Block Exemption for R&D Agreements

- output limitation
 - allocation of markets or customers
- When does block exemption not apply, and the agreement must be assessed individually:
 - between competitors: if market share is above 25%
 - between non-competitors: after their initial R&D agreement (and 7 years from first sale, if joint exploit), if the market share is above 25%

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Block Exemption for Specialization Agreements

- Covers specialization agreements
 - unilateral: one party agrees to cease/refrain from production, in return for other party agreeing to produce and supply
 - reciprocal: each party agrees to refrain, in return for other party agreeing to supply
 - joint production agreements
- Combined market share of participating companies must not exceed 20%
- Cannot include any “hardcore” restrictions

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Guidelines for Horizontal Cooperation Agreements

- Once again, reflects a movement away from legalistic clause-based analysis to a more economic approach
 - guidelines, not block exemption, because provides guidance on a wide variety of types of agreements
- Applicable to agreements between competitors which generate efficiency gains
 - R&D, production, purchasing, commercialization, standardization and environmental agreements
 - where combined market shares are “low”
 - no precise threshold provided
 - market shares below 15% probably OK
 - higher shares may still be considered “low,” depending on circumstances
 - cannot include “hardcore” restrictions
- Specifically do not apply to strategic alliances
 - while individual pieces may be assessed by guidelines, alliance must be analyzed in its “totality”

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Data Protection Directive

- Effective on October 15, 1995; had to be transformed into national law by October 15, 1998
- Establishes legal principles for privacy protection and free flow of personally-identifiable data within the EU
- Principles are both a minimum and a maximum
- Prohibits the transfer of personally-identifiable data from EU countries to any countries which do not have “adequate” data protection laws
 - in other words, the United States

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EU Rights of the Data Subject

- Quite similar to U.S. privacy principles
 - Right to be informed of the purposes of collection, intended recipients, and data subject's rights, at the time of collection.
 - Right to obtain a copy of data about oneself.
 - Right to obtain corrections, erasure or blocking of data processed in violation of the Directive.
 - Appropriate security safeguards must be adopted by controllers of data.
 - BUT BEYOND U.S.: Data cannot be kept for longer than necessary for the stated purposes.
- Problems for U.S. companies:
 - U.S. is a jurisdiction without adequate laws
 - Registration requirements, to the extent the U.S. company is the “controller” of data in the EU

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Methods to Continue EU-to-US Personally-Identifiable Data Flows

- Unambiguous consent of the individual to whom the data relates
- Contractual necessity – for performance of contract; pre-contractual if at the subject's request
- Public interest or legal claims
- Vital interests of subject
- Public data
- US-EU Safe harbor program
- Model contract clauses, based on certain minimum privacy standards

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CASE STUDY #2 Southeast Asia, from a Foreign Counsel's Perspective

- Recurring issues faced by US companies in strategic alliances with Southeast Asian countries
- Presented by Syed Naqiz Shahabuddin, Esq. of Skrine – Kuala Lumpur, Malaysia
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Background on Southeast Asia

- Initial attempts at regional cooperation brought about MAPHILINDO consisting of Malaysia, Philippines and Indonesia - original objective was a political bloc.
- ASEAN was originally formed in 1967. Cooperation amongst Southeast Asian nations has grown in terms of number of members, strength and objectives ever since.
- The Association of South East Asian Nations ("ASEAN") as it is today consists of 10 member States : Malaysia, Singapore, Indonesia, Thailand, Philippines, Brunei, Vietnam, Laos, Cambodia and Myanmar with a combined population of almost 600 million.

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Background on South East Asia

- ASEAN's progress in regional cooperation thus far is commendable and this has been recognized by US.
- Economic cooperation is gradually progressing. The Agreement on the Common Effective Preferential Tariff ("CEPT") (as part of AFTA) hopes to achieve free trade (reduction of tariffs to between 0% and 5% on all manufactures and most agricultural goods) between ASEAN members by 2003.
- Maturity on economic cooperation is necessary to provide the impetus to stimulate the momentum in respect of agreements on other important regional cooperation, such as immigration, social issues, employment issues, environmental issues etc.

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US and ASEAN

- US continues to be ASEAN's chief trading partner.
- US trade and economic presence is recorded in almost every industry -- e.g., petroleum, automotive, consumer products, media, professional services, insurance, finance, advertising, franchising, direct selling and technology (including biotechnology, computer software and hardware, logistics and pharmaceutical).
- Strategic alliances between US and ASEAN companies have been beneficial to both parties. All ASEAN members promote foreign investments and transfers of technology, and offer attractive investment incentives.

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ISSUES FACED BY US COMPANIES

- No marriage is complete without occasional "hiccups." Marriages between US companies and ASEAN companies are no exception.
- Common "hiccups" when dealing with ASEAN companies include :
 - **exchange control issues**
 - **protection of intellectual property**
 - **requirement for specific government approvals**
 - **governing law and dispute resolution clauses**
 - **delays**
 - **transparency**
 - **management**
 - **taxes**
 - **royalty income**

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ISSUES FACED BY US COMPANIES

- Agreements and policy statements of ASEAN have not matured to the extent of EU's agreements and policy statements.
- This can be either good or bad for the US company
 - e.g., unfair competition prohibited in EU, whereas ASEAN has not regulated this aspect of trade
 - data protection regulations in EU are not yet present in all ASEAN members.

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EXCHANGE CONTROL ISSUES

- Most ASEAN countries do not have any restrictions on capital controls. Profits, capital, dividends and interests can be repatriated freely (although levy may be imposed).
- However, in the wake of the ASIAN economic crisis in the late 90s, certain selective capital controls were instituted by ASEAN members
 - e.g., Malaysia, to stimulate the economy and to stabilize the currency as interim measures.
 - Subsequently, most of these capital controls have been abolished, including repatriation of profits and capital.

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PROTECTION OF INTELLECTUAL PROPERTY

- Most members of ASEAN have been placed on the Special “301” provisions of the Trade Act 1974.
 - ‘Priority Watch List’ countries: Indonesia and Philippines
 - ‘Watch list’ countries: Malaysia, Thailand and Vietnam.
- Most infringements relate to optical media piracy, software piracy and counterfeit products.
- Most ASEAN countries have adequate IP laws in place. The complaints have mostly been directed towards enforcement, which have been stepped up lately
 - e.g., Malaysia - successive raids on illegal Vices.

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GOVERNMENT APPROVALS

- Can be divided into two groups :
 - Approvals for foreign equity in general
 - Approvals for foreign equity in particular industries
- In Malaysia, where foreign equity exceeds 30% (in aggregate), approval is usually sought from the Foreign Investment Committee (FIC).
 - There are guidelines to refer to but no set laws.
 - In manufacturing and high-tech industries, participation may be as high as 100%.
- In Philippines, the foreign investment laws and regulations are clearer.
 - One is guided by the Foreign Investment Act 1991.
 - No restriction of ownership unless where the proposed industry falls within one of the subjects listed in the Foreign Investments Negative List, where percentages of equity are spelled out.

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GOVERNMENT APPROVALS

- In Thailand, foreign participation is governed by the Foreign Business Act 1999, replacing the Alien Business Law. It restricts participation in certain industries.
 - American-owned enterprises however may invoke the Treaty of Amity and Economic Relations between Thailand and US to claim exemption (i.e., national treatment to be granted to persons of each country).
- In Indonesia the Capital Investment Coordinating Boards (BKPM) must approve most foreign investment proposals.
 - Some sectors, especially technical sectors, are covered by specific laws and regulations.
 - Fiscal and political deregulation has enabled provincial investment boards to assume a greater role in approving foreign investments within the region.
- Apart from approvals for foreign participation, other forms of approvals, licenses, permits may be required
 - e.g., approval from the Environment Ministry, work permits, registration of drugs, etc.

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GOVERNING LAW AND DISPUTE RESOLUTION CLAUSES

- US companies may wish to choose US laws and US courts.
 - may not be possible in some instances -- e.g., for manufacturing agreements (with more than RM2.5m shareholders funds or more than 75 employees) - one requirement by Ministry of International Trade and Industry that governing law and courts be Malaysian.
- The local company would normally object
 - costs considerations to engage advice on US law, place of business, remoteness of connection, etc.
- US companies are normally wary of the transparency involved in proceedings instituted locally.
- Middle ground - arbitration clause.
 - Malaysia and Singapore appear at the moment to be the favorite locations for arbitration and choice of law in Southeast Asia.

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DELAYS

- Can be a problem at times, but not always.
- Problems occur especially where the local deal is part of a global move or arrangement (e.g., global merger). Timely deadlines have to be met.
- Computerization and backlog are the main problems.

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TRANSPARENCY

- One of the most frequent complaints by US companies especially with regard to decision-making in approvals, tender acceptances, judicial decisions etc. Some ASEAN members have taken commendable measures to increase transparency and good governance
 - e.g., Malaysia : Anti Corruption Agency, Securities Commission stricter regulation rulings.
- CPI or the Corruption Perceptions Index 2001 by Transparency International resulted in the following findings (ranking out of 91 countries):
 - Singapore - 4th
 - USA - 16th
 - Malaysia - 36th
 - Thailand - 61st
 - Philippines - 65th
 - Vietnam - 75th
 - Indonesia - 88th

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MANAGEMENT

- Immigration issues
 - limitation on key and non-key posts
 - foreign management may be restricted.
- Partly local management may be required
 - e.g., local directors, officers.
- Differences in management and corporate culture.
- Language barriers, lack of local knowledge.
- US company's refusal to impart knowledge and skills. Local company fails to pave inroads for US company penetration into local market.

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TAXES AND ROYALTY INCOME

- ASEAN countries provide various forms of tax incentives to specific sectors of industry
 - e.g., free trade zones, pioneer status, MSC status, double deduction. etc.
- Objective of the alliance must be clear - to assist the host country in achieving its objectives - investment, employment, transfer of technology etc.
- Withholding tax on royalty income and interest payments levied on gross amount
 - e.g., 10% and 15%, respectively, in Malaysia.
- Not all ASEAN countries have double taxation agreements with US

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CONCLUSION

- Trade between ASEAN and US is substantial, and is expected to grow.
- US trade and economic presence in ASEAN remains strong, especially in certain sectors.
- US looks forward to stronger ASEAN regional cooperation, in order to ensure political and economical stability.
- Opportunities abound in ASEAN member countries, and incentives are plentiful.
- The issues raised ought not to discourage investment and formation of alliances. There are measures that can be adopted to mitigate these risks.
- Remember : where there is a problem, there is always an opportunity.

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