Contract Terms in Supply Agreements

China

Supply Contracts in China 中国合同

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Chinese Supply Contract Terms 中国合同

- Introduction – Harmony in Business
- Contract Terms
  - Exclusivity
  - Delivery and payment period specifications
  - Intellectual Property Rights
  - Confidentiality
  - Payment Terms
  - Language
- Law and Jurisdiction
- Arbitration

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Chinese Supply Contract Terms 中国合同

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Introduction - Harmony in Business

There is a belief that in China the agreements set out in contracts are often not complied with, and that the system does not provide sufficient legal guarantees; in this regard, it is widely thought that signing a contract is merely the start of the real negotiations.

Therefore, it is essential for foreign companies to have contracts whose essential role is to reduce the risk of conflicts as much as it is possible: Chinese business culture is based on harmony between the Parties.

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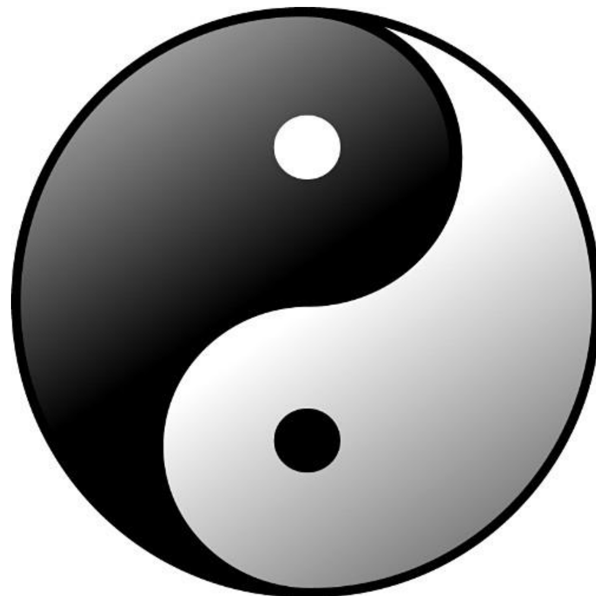
Introduction - Harmony in Business



Contract Terms

Some of the most important contract terms in Chinese Supply Contracts are as follows:

- Exclusivity
- Delivery and payment period specifications
- Intellectual Property Rights
- Confidentiality
- Compensation
- Language

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Exclusivity

Chinese companies, on the strength of their great negotiating power, often demand that the foreign company should grant them exclusivity in all - or part - of Chinese territory in supply contracts.

Foreign companies are advised, however, not to grant this exclusivity, because in addition to not being able to use other distribution channels, in the event of inefficient management by their Chinese partner, their access to the market would be suspended until the contract is terminated.

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Delivery and Payment Period Specifications

In contracts with Chinese companies, it is important to clearly specify the place the goods are to be delivered. It will usually be a seaport which will have to be mentioned in the supply contract - if it is going to be the usual port - or in the shipment orders, as can happen in the supply and OEM manufacturing contracts.

As far as payment is concerned, the common practice is for the payment period (usually 30 days) to begin on the date the goods are inspected and approved in the port of origin, rather than on the shipping date or acceptance date of the goods at the destination.

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Intellectual Property Rights

This is an essential point in any contract with a Chinese company in light of the well-known difficulties faced by foreign companies in protecting intellectual property in China.

A clause must be included whereby the Chinese partner acknowledges that these rights (patents, trademarks, designs, utility models) are the property of the foreign company, and also undertakes not to apply to register these rights in China or also in other countries.

In any event, as well as including this clause in all contracts carried out in China, foreign companies are advised to seek legal advice regarding this matter and to consider the possibility of registering their Intellectual Property Rights in China.

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Payment Terms

Chinese law is less protectionist than in countries of the European Union or the United States when dealing with the right of compensation in the event of termination of supply contracts.

Thus, in the Compensation Clause the foreign company is recommended to choose the option of compensation in accordance with Chinese laws.

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Language

In China, supply contracts are usually drawn up either in English or in a dual English-Chinese version. It is not common to sign supply contracts in other languages such as Spanish, French or German. For the version in Chinese, simplified Mandarin Chinese shall be used.

It is advisable to use the dual English-Chinese version as this will make it easier to negotiate the contract, and also help compliance with obligations and an amicable settlement in the event of conflict.

However, when using the English-Chinese dual version, the Chinese company would try to insist that the Chinese version prevails in the event of conflict.

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Law and Jurisdiction

In accordance with Chinese laws (PRC Civil Law), the Parties are allowed to choose the law and jurisdiction they wish to apply in supply contracts with foreign companies.

Nevertheless, in commercial practices Chinese companies refuse to sign supply contracts in which matters of litigation are not referred to the Courts or Arbitration Commissions of China.

The questions of which procedure to choose will depend particularly on the power and influence of the Chinese Party and the prestige of the Court proposed by the Chinese company; as a general rule, it will be preferable to choose the alternative of Arbitration rather than the Court.

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Arbitration

In supply contracts subject to Arbitration in China, it is advisable to act as follows:

- Choose one of the Arbitration Commissions with most prestige and international experience: CIETAC (China International and Economic Trade Arbitration Commission) or BAC (Beijing Arbitration Commission). Chinese companies will not oppose at this point.
- Regardless of where the central office of the Chinese company is located, it is preferable for the Arbitration to take place in Beijing or Shanghai, the two cities with most experience and the best arbitrators.
- The arbitration will be carried out in the English language. It is important to take into account that if no language is specified in the supply contract, the arbitration will be in Chinese. At this point, Chinese companies would be expected to object strongly, and might even use it as grounds for not signing the supply contract.

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Mexico

Supply Contracts in Mexico

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Supply Contracts in Mexico - Key Considerations

- Mexico is a Federal Republic – 31 states and a Federal District
- Mexico is a civil law jurisdiction and its contract laws are codified in the Federal and States Civil Codes and in the Federal Commercial Code
- The Federal Commercial Code governs commercial matters, including purchases, sales and leases of personal property entered into for business purposes; agreements regarding commercial transactions; and purchase and sale of real estate for commercial purposes
- Federal and State Civil Codes address commercial contract law issues not otherwise covered by Commercial Code, including elements of contract formation

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Supply Contracts in Mexico - Contract Formation

- Generally only two elements are required to be satisfied to create a valid and enforceable contract: 1) consent, and 2) object. Note: Consideration is a not a requirement
- The consent element is satisfied when there is a manifestation by the parties of an intent to be bound by an agreement.
  - Can be express (through speech or writing) or implied (based on the parties' actions)
- A contract must have as its object either 1) a physical thing to be exchanged, which must:
  - exist in nature
  - be determined or determinable
  - be subject to commerce (that is, in accordance with the law)
- or 2) a particular act or set of acts that must be performed or abstained from being performed, which act or acts must be:
  - physically possible
  - legally possible
  - legal

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Supply Contracts in Mexico - Contract Formation

- Common law requires a bargained-for exchange (or that the promisee suffer a legal detriment) to perfect a legally enforceable contract
- Mexican law does not impose a consideration requirement
  - i.e. a contract for the sale of property is binding even if the promissee has not offered anything in return

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Supply Contracts in Mexico - Formalities

- Certain types of contracts are required to be in writing in order to be enforceable, including
  - supply contracts
  - leases
  - letters of credit
  - chattel mortgages
  - company loans
  - letters of intent
  - promises to contract
- Pursuant to the US State of Frauds, only contracts that cannot be completely performed within a year of execution, contracts for the sale of land, and contracts in which one party acts as a guarantor for another's debt or other obligation, must be in writing

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Supply Contracts in Mexico - Formalities

- To have effect as against third parties, certain contracts also need to be recorded before a corresponding public registry in Mexico
- Contracts that must be recorded include:
  - incorporation documents
  - contracts for the sale of real estate
  - powers of attorney
  - M&A agreements
  - contracts for the purchase and sale of shares
- To ensure validity, advisable to register all commercial agreements in a public registry with the aid of a notary public

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Supply Contracts in Mexico - Powers of Attorney

- For an individual to act on behalf of a corporation, including with respect to the execution of contracts intended to bind the corporation, a valid power of attorney is required
- Unlike in the US, corporate officers retaining counsel to act on behalf of a corporation in Mexico require a power of attorney (valid under the laws of Mexico) to do so
  - documents filed by attorney not properly authorized to do so, may be deemed not filed
  - failure to follow proper PoA formalities in retaining attorney can result in default in litigation
- PoAs must be 1) issued before a notary public, and 2) satisfy all other requirements of a public deed

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Supply Contracts in Mexico - Choice of Law and Choice of Forum

- Generally, choice of law and choice of forum provisions will be enforced by Mexican courts
- The following areas are left exclusively to the domain of Mexican courts:
  - criminal liability
  - real estate
  - tax
  - corporate insolvency
- Disputes related to land and water resources within Mexican territory as well as actions of local agencies and states, will remain subject to Mexican law

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Supply Contracts in Mexico - Remedies; Liquidated Damages

- Upon breach by one party, the other party to the contract may
  - rescind the contract – has the effect of terminating the legal effect of the contract and creates the requirement that both parties return the consideration received
  - file an action for specific performance – if the object of the contract is personal or real property, and the non-performing party was obligated to convey ownership
  - sue for *daños* (out of pocket expenses) and *perjuicios* (loss or earnings or expected profit)
- Liquidated damages provisions are enforceable, but the amount of such damages may not exceed the amount of the principle obligation under the contract

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Brazil

Supply Contracts in Brazil

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Supply Contracts in Brazil - Key Considerations

- Brazilian contract law is codified in the Brazilian Civil Code
- As long as the parties comply with the provisions of the Civil Code respecting commercial contracts, they are free to define their business relationship as they see fit
- This includes agreement as to sales prices, territory, trademarks, service and maintenance of products, inventory requirements and termination

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Supply Contracts in Brazil - Contract Formation

- Brazilian contracts, as in the US, are formed through offer and acceptance; however, consideration is not a necessary element for the perfection of an enforceable contract

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Supply Contracts in Brazil - Choice of Law

- Parties are free to choose the applicable law for contracts to be performed in Brazil, provided the law chosen has some nexus to the transaction

- The law chosen must conform to Brazilian public policy and good morals, and the effectuation of the choice of law must not interfere with national sovereignty

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Supply Contracts in Brazil - Agent or Representative

- Under Brazilian law 4.886/65, amended by Law 8.420/92, a commercial representative is:
  - one that acts as an intermediary promoting a product or service, looking for customers, negotiating proposals and orders and forwarding them to the seller with whom it has a contractual relationship

The Civil Code (Law 10406 of 10/01/2002) refers to Commercial Representation as "**Agency**".

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Supply Contracts in Brazil - Agent or Representative

Distributorship relationships are primarily regulated by Brazilian contract law; and, unlike commercial representative relationships, there are very few statutory provisions governing distributorships

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Supply Contracts in Brazil - Mandatory Provisions

- Term of the agency
- Obligations of the parties
- Description of the products or goods that are the object of the agency
- Description of the territory
- Exclusivity
- Payment structure (commission and time of payment)
- Termination
- Commercial Representative must register with the Regional Council of Commercial Representatives

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Supply Contracts in Brazil - Choice of Forum and Arbitration

- Arbitration clauses are enforceable; agreements to arbitrate must be in writing and be either included in the supply contract to which they relate or in a separate document that expressly refers to such supply contract
- To be enforceable in Brazil, an arbitration clause intending to bind a Brazilian party must also:
  - clearly establish that the controversy at issue is to be resolved through arbitration
  - identify the arbitral institution that will administer the arbitral proceedings
  - select the applicable law and place of arbitration
  - provide a procedure for the selection of the arbitrators

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Supply Contracts in Brazil – Disputes and Termination

- Termination
  - Brazilian law requires that all disputes between a foreign company and its commercial representative be venued in Brazil and judged in accordance with Brazilian law
  - Article 35 of the Brazilian Civil Code provides a list of "just cause" reasons for the termination of a commercial representative agreement
  - If the relationship is terminated for cause, no indemnification is owed to the commercial representative. However, if the relationship is terminated for reasons other than those listed in Article 35, Brazilian law may require an indemnification payment to the commercial representative

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Supply Contracts in Brazil - Disputes and Termination

- Termination – FOR CAUSE
  - Article 35 provides a list of just reasons for termination of an agency agreement, these include:
    - neglect of the agent in the accomplishment of his obligation(s) under the contract
    - engaging in acts which result in loss of commercial credit of the represented
    - conviction for a crime considered injurious to the represented
- The represented may retain the commissions due to the agent if there is just cause for the termination of the agreement, so long as retaining the funds is made with the purpose of recovering damages caused by the agent

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Supply Contracts in Brazil - Disputes and Termination

- Termination – WITHOUT CAUSE
  - Generally, an agent is entitled to no less than 1/12th of the total amount received during the time of agency
  - If the agency is for a specific term, the agent is generally entitled to an amount equal to the monthly average compensation received multiplied by the remaining months left in the agency contract term
  - Plus, investments made to open the market

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EU Countries

Contract terms in EU Countries laws

- Introduction: Common law vs. Civil law
- Binding character of an offer in EU Countries
- "Hidden" provisions in EU contracts

  Two examples

  - Abuse of right
  - Good Faith
- Limitation of liability clauses
- Battle of the forms
- Governing law and forum clauses

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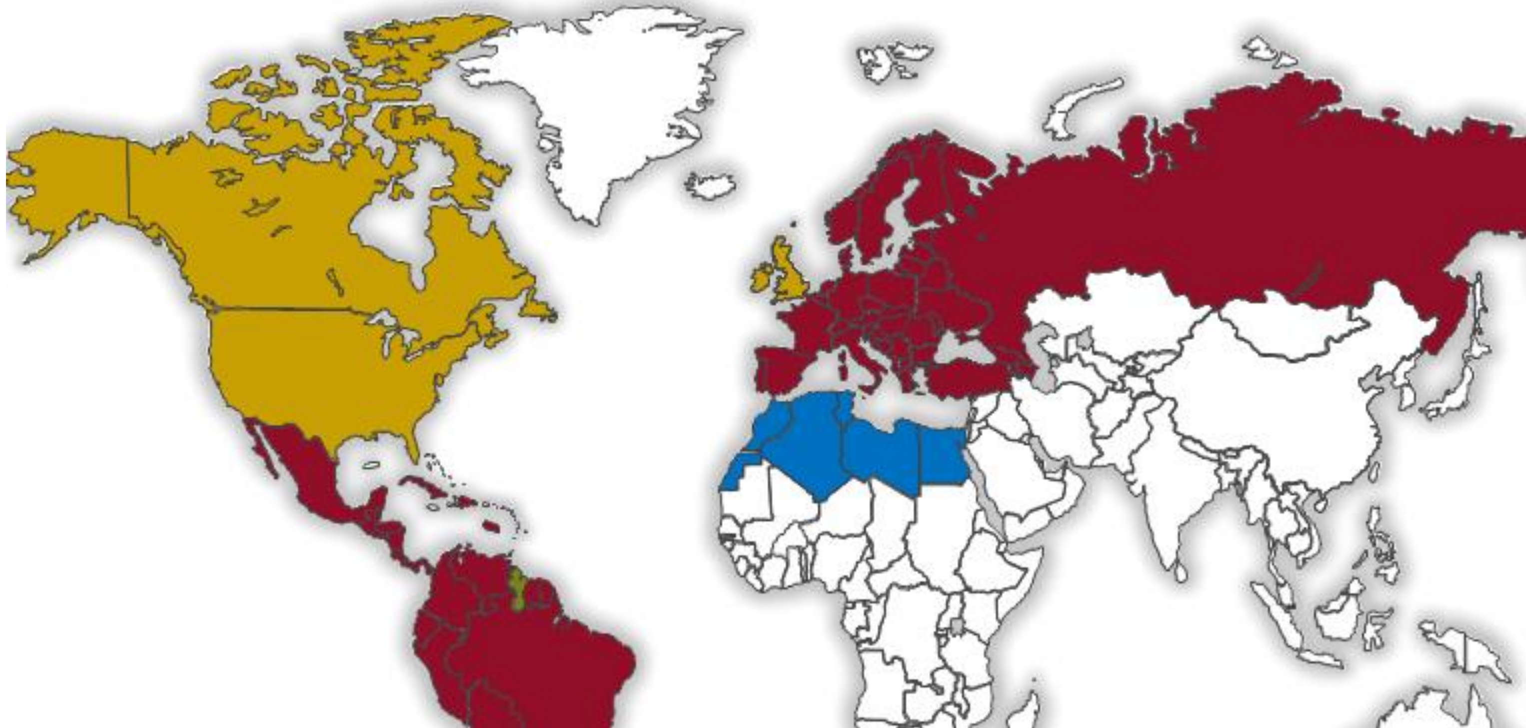
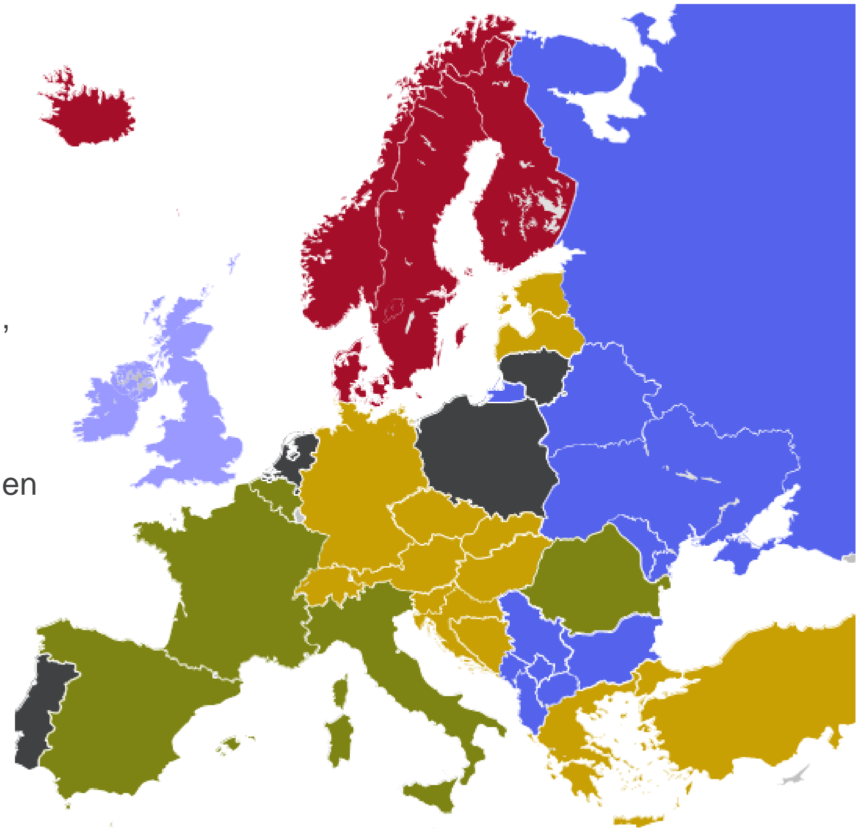
Introduction: Common law vs. Civil law



Introduction: Common law vs. Civil law

Various civil law systems

- **Napoleonic**: France, Spain, Italy, Belgium, Luxembourg, Romania (same as in Quebec and Louisiana)
- **Germanistic**: Germany, the Netherlands, Austria, Switzerland, Estonia, Czech Republic, Hungary, Greece, Portugal…
- **Scandinavian**: Denmark, Finland, Iceland, Norway and Sweden



! Contract law is also regulated by national specific laws (e.g., Belgian distribution Act, …)

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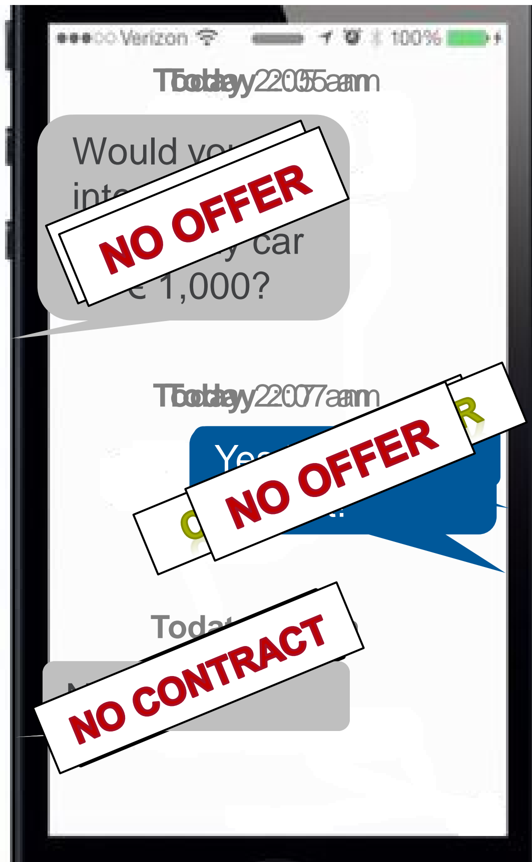
Binding character of an offer in EU countries



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Binding character of an offer in EU countries

Offer components:

- intention to create legal relationship
- covers core contractual elements (object, price…)
- brought to recipient's attention

➢ Irrevocable character (for limited duration)

➢ Upon mere acceptance, a valid contract exists

THINK TWICE : Upon mere issuance of a counteroffer ("yes, but…"), the initial offer **disapears**!

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Binding character of an offer in EU countries

Meeting of the minds: when two parties to an agreement have the same understanding of (essential) terms of the agreement

Consequences:

- Signature or other form of formal execution is not required
- Even written contract can be amended by a mere accepted offer
- Transfer of title and of risks (generally) occurs upon acceptance

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Binding character of an offer in EU countries

- ... <u>before</u> the contract is formed:
  - principle: freedom to negotiate
  - exception: abuse of negotiations

The French example:

- conduct negotiations without serious chances to succeed ("leading to believe")
- abrupt termination of negotiation without justification
- enter into a contract with third party while negotiations are pending
- abusive use of information collected during negotiations

Culpa in contrahendo: "*Parties must act in good faith during preliminary contract negotiations and have a duty to negotiate with care, and not to lead a negotiating partner to act to his/her detriment before a contract is concluded*".

Remedy	Compensation for **damages & loss**: costs incurred in the negotiation, loss of opportunities, reputational damages…

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‘Hidden’ provisions in EU contracts

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‘Hidden’ provisions in EU contracts

Common Law	Civil Law
Extensive freedom to contract	Freedom to contract but more mandatory limitations and implied provisions
Parties are bound by contract	Parties are bound by contract and by supplementary rules they did not exclude
Parties should comply with contract terms	Parties should perform contract in good faith and without abuse or imbalance
Courts apply contract	Courts apply contract (to the extent compliant with above principles) and ‘hidden’ provisions

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‘Hidden’ provisions in EU contracts

‘Hidden’ provisions in EU contracts ?

Mandatory
- ✓ Abuse of right
- ✓ Good Faith
- ✓ Statute of limitation
- ✓ …

Mix
- ✓ Liability / limitation of liability
- ✓ Warranty
- ✓ …

Supplementary
- ✓ Termination clauses / resolution
- ✓ Force majeure
- ✓ Applicable law / forum
- ✓ …

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‘Hidden’ provisions in EU contracts

Content of the agreement can also be supplemented by the court with rules based on equity or usages (e.g. interest rates, liquidated damages, …)

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‘Hidden’ provisions in EU contracts

Mandatory

Abusive of Rights

- Exists in most Civil Law jurisdictions

“ ***Malicious or antisocial exercise of otherwise legitimate rights can give rise to civil liability*** ”

- Cases of application:
  - predominant motive for exercising one’s right is to cause harm
  - no serious or legitimate motive exists for exercising the right
  - the exercise of one’s right is against moral rules, good faith, or elementary fairness/equity
  - the right is exercised for a purpose other than that for which it was granted

Remedy

“**Fault**” entitling a claimant to damages or reparation

Disqualification from the right to rely upon the abusive right

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‘Hidden’ provisions in EU contracts

Good Faith

- Exists in most Civil law jurisdictions

> **“ An expectation of each party to a contract that the other will honestly and fairly perform his duties under the contract in a manner that is acceptable in the trade community ”**

- The German example:
  - German law sets out the superior ethical principle of “*Treu und Glauben*” (“sincerity and faith”)
  - Applies both to the formation and the performance of the contract
  - Paragraph § 242 of the German Civil Code (BGB) establishes the obligation to perform contracts in good faith
  - According to paragraph § 157, contract interpretation should be made in light of good faith

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Limitation of liability clauses in EU contracts

Typical civil law **liability regime** (implied in any contract):

- Damages: actual losses incurred (*damnum emergens*) and the lost profit/advantages (*lucrum cessans*) (+ '*consequential damages*')
- Extent of the liability: (if non-performance was unintentional) only foreseeable damages at the time the contract was entered into
- Even if the non-performance was intentional, only damages that are causally linked to the contractual breach can be compensated, i.e. only damages that would not have been suffered without the non-performance

GOOD TO KNOW

Punitive damages: generally not allowed (except for abusive appeal of a court decision)

Liquidated damages: in principle allowed but could be reduced by Courts where excessive in regard to damages that could have been foreseen at the time of entering into the contract

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Limitation of liability clauses in EU contracts

Limitations are in principle **valid**

but you generally **cannot**:

- Limit or exclude liability for death or personal injury
- Limit or exclude liability for:
  - Fraud
  - Intentional fault
- Exclude liability for any default or negligence with the consequence that there is no real commitment left
- …or the remaining commitment is substantially not in relation to the original one

… you **can** thus **excude** e.g.:

- negligence, including gross negligence, and tort (watch for "essence of the agreement")

Potius ut valeat : An exclusion of liability would be interpreted "within what is legally possible"; one would not strike out the entire clause for "over-reaching"

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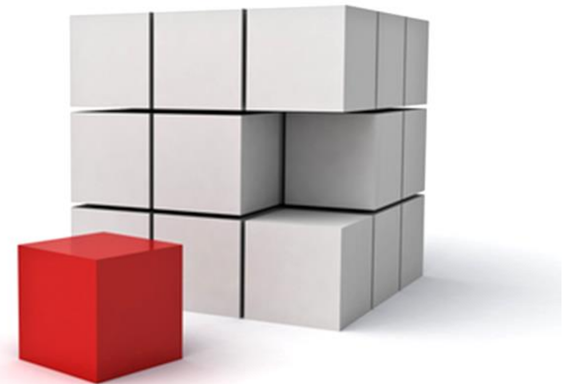
Limitation of liability clauses in EU contracts

Non contractual liability (including *culpa in contrahendo*) may also be contractually regulated provided:

- You think of it
- You keep in mind that it is territorial
- It is not mandatory (French law)



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Limitation of liability clauses in EU contracts

Best practices

as supplier

Must

- Limit liability to damages that are the **direct and immediate** consequence of a contractual breach
- Expressly **exclude** loss of profits, income, loss of revenues, loss of business, loss of contracts, loss of goodwill or reputation, loss of anticipated savings, or indirect or consequential loss of any kind
- Must state that excluded damages are **not recoverable** (even if such damages were foreseeable or if the purchaser advised supplier of the possibility of such damages)
- Impose on purchaser the obligation to **mitigate the damages** that it suffers
- Severability clause

Don't

- Include indirect, consequential, incidental or punitive special, exemplary damages
- Accept any exclusion of mitigation of damages

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Limitation of liability clauses in EU contracts

Do not confuse:

Performance	Delivering what you committed to deliver
Liability	Repairing the prejudice caused by your contractual default or non-contractual negligence
Warranty	Guaranteeing that a product or service is conforming to the order and free from defects, especially hidden ones

Make sure to address in contract **each of these three** performance, liability and warranty segments !

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Limitation of liability clauses in EU contracts

Warranty

Warranty/Liability for non-conformity and **visible defects**

- May be covered by customer
- May be limited/excluded with some commercial 'sense'

Warranty/Liability for **hidden defects**

- May be limited/excluded (not possible for professional vendor of goods…)
- Short term liability (term can be shortened contractually, if long enough to reasonably allow the discovery of the defect)
- Short term to file claim (may be set contractually but must be reasonable)

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Battle of the forms

Two types of rules are applied to solve the battle of the forms:

Last-shot rule

(England, the UN 'Vienna' Convention on the International Sale of Goods)

"Where conflicting communications are exchanged, each is considered to be a counter-offer and the final contract will be governed by the terms of the last document exchanged between the parties"

- contract does not come into existence as long as offer and acceptance do not match
- each party's reference to its own general conditions is considered a rejection of the other party's offer and treated as a counteroffer
- only if one party accepts the other party's offer - including its general conditions - is a contract formed
- terms of the contract are those of the party whose offer has been accepted and thus of the party who has managed to "fire the last shot"
- **problem**: it impedes voluntary exchange, fails to promote efficient contract terms and incurs relatively high transaction costs

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Battle of the forms

Knock-out rule

(Germany, France, Belgium, Luxembourg, …)

"To the extent the parties' terms are in agreement, they become part of the contract"

- contract comes into existence even though due to the differing general conditions offer and acceptance do not perfectly match
- terms governing the contract are those that are common in substance in both sets of general conditions
- differing terms knock each other out and are replaced by the default rules of the law
- Problem: does not manage to promote efficient contract terms

The German example:

- application of knock-out rule depends on the parties' indication that they only want to contract under their own terms and that they reject the other party's terms
- there is still room for the last-shot rule where the parties do not explicitly insist on their own terms or do not explicitly reject the other party's terms

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Battle of the forms

Best practices

in continental Europe

Standard terms should always contain '**defensive clauses**', which explicitly state that the contract is only subject to the party's own terms and/or that the other party's terms are rejected (not necessary e.g., in France)

Example:

"*These general terms and conditions of sale prevail over any terms and conditions of the Buyer or its intermediaries notwithstanding any provisions to the contrary in such other terms and conditions*".

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Governing law and forum clauses

Choice of law

- Freedom to choose applicable law
- But, in purely national context (e.g. French supplier and French customer), choice of foreign (e.g. English) law will not preclude application of mandatory national rules
- Attention: also include choice of law for non-contractual (tort) matters

By default (in internation sales of Goods): **Vienna Convention**:

- offers accepted substantive rules on which contracting parties, courts, and arbitrators may rely
- deemed to be incorporated into (and replace) any otherwise applicable domestic law

Not ratified by U.K.

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Governing law and forum clauses

The European example: Rome I Regulation

- applies in case of a conflict of laws between two European parties (not DK)
- applies to contractual obligations in civil and commercial matters in the event of a conflict of laws (not to pre-contractual phase, choice of courts/arbitration, questions governed by company law, etc.)

Principles:

- absolute freedom of choice (law of an EU MS or not; link with the parties or not; even a non-state body of law)
- choice of law will not exclude application of super-mandatory laws

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Governing law and forum clauses

Choice of forum

- Criteria of choice
  - Convenience (home Judge, …)
  - Preferred judicial system (civil/common law, discovery, interim remedies available, timeliness of procedures, …)
  - Enforcement (location of defendant's assets, ...)
  - … may lead to choose arbitration (enforceable by virtue of NY Convention)

- Good practice
  - clause should be drafted widely
  - and made « exclusive »

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Governing law and forum clauses

The Hague Convention of 30 June 2005 on Choice of Court Agreements

- Basic rules:
  - Chosen court must in principle hear the case (Art. 5);
  - Any court not chosen must in principle decline to hear the case (Art. 6); and
  - Any judgment rendered by the chosen court must be recognised and enforced in other contracting country, except where a ground for refusal applies (Arts 8 and 9)
- Applies only to ‘exclusive’ choice of Court agreements…
- … concluded in civil or commercial matters (except insurance contracts)

The Hague Convention has been signed but not ratified by the U.S. yet!

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