

Distribution Agreements in Ukraine: Top of the Iceberg



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Almost all companies manufacturing and selling goods face time when they have to take their businesses to the next level and move beyond the scope of their local or original market. In such cases it can be a good idea to outsource the distribution of your product on new markets or even your original market so you can concentrate on its manufacture. The outsourced distribution has been used efficiently and profitably for such purposes on foreign markets as well as globally. It goes without saying that like commercial agency and franchising, distribution is a quite flexible and very convenient vehicle to capture foreign markets. Distribution is also soaring recently at the Ukrainian market (e.g. automotive industry, clothing, food, cosmetics, medicine, etc.).

First of all, distribution contracts are integral tools in the construction of a business/commercial relationship between distributors and suppliers. Well-drafted agreement can help in developing the relations but in no way can they extend their duration once the commercial interests and/or relationship expire. However, poorly drafted contracts may turn into a legal battle that may be timely and financially consuming and burdensome. What a well-written agreement can do is to eliminate or at least limit the said expenditures and encourage both parties not to think about battle but about

their business after commercial relations expire. The latter is even more important in cases of cross-border contracts, where the parties may face not only different legal regulations but also different commercial mentalities.

In this article our aim is to focus mainly on major legal “hidden reefs” to be borne in mind by foreign suppliers, while entering

into distribution contracts with their Ukrainian counterparties.

Regulation of distribution under Ukrainian law

Even though distribution relations and contracts are commonly employed in Ukraine, they are not specifically regulated in Ukraine.



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However, similarly to the USA where certain businesses are subject to industry-specific legislation at both the federal and state levels defining how the distribution relations are created, structured and terminated (e.g. autos, farm implements, agricultural equipment, livestock equipment, machinery, power equipment, utility equipment, mobile home dealers, marine products, etc.)¹, Ukrainian law in different spheres operates with the notions “distribution”, “distributor”, “dealer”, “dealer activity” and stipulates mandatory requirements to be obeyed by both suppliers and distributors, to name but a few: distribution of medicines, autos, securities, etc.

However, contrary to some other jurisdictions, e.g. Italy, Germany, where pursuant to well-established case law distri-

bution arrangements may come under regulations on franchising (e.g. pre-contractual disclosure requirement) or commercial agency (e.g. goodwill compensation (indemnity)², neither Ukrainian courts nor other involved state agencies have yet established a firm practice on the ruling and interpretation of distribution related issues.

In the absence of specific regulations and established case law, distribution contracts are generally concluded in Ukraine proceeding from the rule of freedom of contracts provided by the *Civil Code* and taking into account regulations on competition, quality/safety of goods, protection of consumer rights, intellectual property rights and advertising, etc., as well as customary business practices, general requirements

on reasonableness and equitableness.

Exclusivity

It is noteworthy that neither Ukrainian law nor case law directly address the issue of exclusivity. Hence, to be on the safe side it is crucial to precisely identify directly in the distribution contract the exclusivity scope, the respective rights and obligations of parties and any applicable limitations.

Non-compete obligations

Non-compete obligations are a common tool for almost all cross-border distribution contracts as they allow profits to be maximized from distribution activity on a particular territory.

Notably, Ukrainian law considers some non-compete restrictions frequently used in distribution contracts for other jurisdictions as anticompetitive concerted actions that are directly prohibited, to name but a few: setting prices or other conditions of acquisition or sale of goods; dividing markets or sources of supply on the basis of territory, assortment, volumes of sales or acquisition, range of sellers, purchasers or consumers, or on the basis of other features, etc.

At the same time, Ukrainian law provides for certain exceptions allowing for the stipulation of non-compete obligations, namely:

(i) If non-compete obligations are in compliance with typical requirements (mainly relating to market share, asset value and sales volumes) approved by the Antimonopoly Committee of Ukraine (Committee);

(ii) Concerted actions related to supply and use of goods, namely the following restrictions are not prohibited:

¹ According to country reports on distributions posted on the web-site: www.idiproject.com

² Ibid.

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(a) Related to use of goods supplied by a participant, imposing limitations, or other suppliers;

(b) Related to acquisition of other goods from other legal entities or sale of other goods to other legal entities and consumers;

(c) Related to acquisition of goods, which, by their nature or in accordance with trade and other fair practices of business activities, do not belong to the subject-matter of the agreement;

(d) Related to specification of prices or other conditions of an agreement for the sale of the supplied goods to other legal entities or consumers.

However, there are still some exceptions from the said rule to be analyzed by the parties to the distribution agreement in view of the specifics of their transaction.

(iii) Concerted actions related to transfer of intellectual property rights objects or rights to use such objects.

As of today the issue of major concern is the absence of well-established practice and comprehensive official interpretations related to distribution contracts. Hence, the Committee defines whether the distribution contracts' non-compete provisions are in line with Ukrainian law on a case-by-case basis and their decisions strongly depends on market conditions in the relevant sphere, i.e. the total number of the companies/competitors selling similar goods, their market share, type of products, etc. Besides, to be on the safe side, in certain cases it makes sense for the parties to the distribution contracts to approach the Committee to obtain its preliminary conclusions as to the concerted actions, even though in practice such a procedure is quite burdensome.

Intellectual property rights issues

As a rule, the distribution contracts address IP issues very generally without due attention to the following applicable requirements of Ukrainian law

related to the so-called license clause:

(i) In Ukraine IP objects subject to registration (e.g. trademarks) may be licensed only after their due registration;

(ii) The license clause (agreement) to be effective and operative in Ukraine shall be entered into in writing and signed by the parties;

(iii) Only types of use directly stipulated in the license agreement (license clause) shall be regarded as granted. Notably, Ukrainian law defines particular types of use for each IP object to be duly reflected in the distribution contract. For instance, under the *On Protection of Rights to Signs for Goods and Services Act of Ukraine* the following shall be regarded as use of a trademark: (a) placement of the trademark on any goods, for which the latter is registered, on packaging of goods, signs, labels, tags or any other object attached to goods, storage of such goods aimed at offering thereof for sale, offer thereof for sale, sale, import and export; (b) use of the trademark, while offering and rendering any services, for which the trademark is registered; (c) application of the trademark in commercial documents or in advertising and in Internet. Similar lists of the allowed types of use are directly set out for inventions, industrial designs, etc.

Ignoring the said requirements may entail major risk for the parties of being unable to fully protect and to prohibit unauthorized use of such objects by third persons, as well as cause some problems in relations with the Ukrainian tax authorities and banks in case of royalty payments.

Product liability issues

Ukrainian legislation stipulates numerous different requirements in the field of product liability to be obeyed either by a

seller of the goods, a manufacturer producing the goods, any individual or legal entity putting his trademark, name or other indications on the goods, authorized representative of foreign manufacturer or an importer. Moreover, any restrictions provided in the distribution contracts that may be regarded as limiting consumer may potentially be declared invalid. Needless to say, enforceability of any product liability provisions of distribution agreements shall be carefully considered by the parties.

Applicable law

The choice of a foreign law as an applicable law for an international distribution agreement is fully effective and enforceable under Ukrainian law. However, the mandatory rules of Ukrainian legislation regulating the corresponding legal relationships shall apply irrespectively of the applicable law. It shall be noted that even if foreign law is chosen as the governing law, this will not always prevail. The choice of law made by the parties may be overturned in Ukraine on public policy grounds. In these cases the law of the closest connection shall be applicable, and if the latter cannot be established or applied, the legislation of Ukraine shall apply. Therefore, it goes without saying that parties shall always consider public policy issues while choosing the applicable law.

If the parties fail to agree on the law to govern the agreement, the latter will be governed by the law of the country, which has the closest connection to the transaction. If other is not foreseen by or does not follow from the conditions or content of the transaction or from all circumstances of the case, then a transaction is deemed to have the closest connection to the law of the state, where the party, that shall perform execution to be of the decisive value for the

content of the transaction, has its residence or location. Taking into account the writings of scholars we believe that in case of distribution agreements it will be the law of the distributor's residence or location.

Dispute resolution clause

Sometimes foreign suppliers taking into account their standard practice in the distribution agreements with Ukrainian counterparties provide for exclusive competence of foreign state courts as to any disputes arising between the parties hereunder. However, proceeding from the applicable legislative provisions and case law, we believe that there are too many legal and practical issues in Ukraine as to the exclusive choice of forum clauses enforceability in Ukraine and recognition and en-

forcement of relevant judgments. Even more issues arise in case of absence of the mutual legal assistance treaty between Ukraine and the relevant country setting out the relevant provisions on the choice of forum. Moreover, a choice of forum clause favoring foreign courts will not preclude a Ukrainian distributor from filing a claim with the Ukrainian courts in certain cases.

Therefore, in order to diminish the above risks the parties may refer disputes arising from the distribution agreements to international commercial arbitration either in Ukraine or abroad (either institutional or ad-hoc), subject to legislative provisions on arbitrability of the country chosen as place of arbitration. Notably, under Ukrainian law such disputes may be referred to international arbitration. Ukraine is a party to the *New York Convention 1958* and

foreign arbitral awards are subject to recognition and enforcement in Ukraine.

Moral of the tale

Therefore, in order to avoid problems at the time of a distribution contract's performance and/or termination, in addition to reflecting commercial interests therein, parties must ensure that the contract regulates all major issues (nothing commercially important is omitted), its provisions are clear, sound, effective and fully enforceable in Ukraine. In order to make the said provisions fully operative and enforceable in Ukraine as well as to eliminate or at least to diminish all applicable risks, the parties thereto shall bear in mind the myriad of legal issues set out by Ukrainian law and shall duly address them in the distribution contract.

The PARTIES shall BEAR in MIND myriad of the LEGAL ISSUES set out by Ukrainian law and shall duly ADDRESS THEM in the DISTRIBUTION CONTRACT

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