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Main legal issues in international business expansion

Expanding internationally is most of the time critical for businesses wishing to break into other markets. However, international expansion is not without posing a number of risks, in particular legal and financial ones, that need to be identified and addressed upstream when designing the overall expansion strategy.

While the choice of the most appropriate legal structure or export business model is essential, companies must also keep in mind other legal considerations.

This article is a follow-up to the conference on "*Successfully establishing a presence abroad: The legal and financial basics*" organized by our Firm together with Banque Rhône-Alpes on May 31, 2018.

Establishing a presence in, or breaking into, a foreign market is not something that can be done overnight as it can represent a real risk for any company that is not adequately prepared or that has not chosen the legal structure or approach best suited for its expansion project and the target market.

Any business operator wishing to expand internationally has a wealth of possibilities, but to ensure a successful expansion it is necessary to identify the key factors and to properly delineate the project to subsequently determine the best structure to be put in place.

1. **The choice of the structure depends on the objective pursed by the company**

The choice of the structure that will be used by the company requires above all the proper identification of the project and the pursued objectives.

Indeed, does the company wish to engage into prospecting activities, to sell or buy products on a specific market, or even to manufacture its products directly in such market? Is the contemplated expansion part of a short-term or long-term business project? Moreover, does the company already have relationships with local partners and does it intend to set up a partnership or a joint venture with one or more of these partners?

Before embarking on any international expansion project, it is also vital that the company carefully assess its export potential and identify its strengths as well as the means and resources that it can deploy and assign to such project.

Developing an export activity is costly and the company must promptly determine the human and financial needs that it can allocate to this form of expansion. In addition, its capacity to manage the project (legal expertise, language skills, existence of an export department or internal export expertise, etc.) and any past international experience are also criteria that need to be considered to fully understand the issues at stake and have all that is necessary to succeed abroad.

2. **Possible structures**

There exist several ways to expand internationally and establish a presence abroad. Each way has its own degree of integration and level of risks:

- Commercial agent;
- Distributor;
- Representation office;
- Branch;
- Joint-venture ;

If the company intends to engage into prospecting activities or test its products or services on a foreign market, the use of a commercial agent or the creation of a representation office appears more appropriate than the creation of a subsidiary or the establishment of a branch.

A subsidiary, i.e. an entity that is legally autonomous from its parent company, can be a good option if the company wishes to duplicate its production or marketing model and its operating method in the foreign country.

In addition to these considerations, other factors must be taken into account, such as tax issues (taxation of profits, VAT, parent-subsidiary preferential tax regimes, transfer pricing), labor- and employment-related issues (status of expatriate employees or local employees), the protection of intellectual property rights beyond borders (patent, trademark, know-how) as well as potential regulatory restrictions on foreign investment in the target market. Some countries, such as China, Iran or the United Arab Emirates, require or strongly recommend the creation of an independent local unit on their territories.

The creation of a joint-venture together with a local partner will help the company rely on a market player that has a good knowledge of the market and the way it operates. Through the creation of a joint subsidiary, a contractual partnership will be put in place and enable to respond jointly to any request for tenders for a specific project. This type of structure can be a good way to respond to the obligation imposed by some counties (China, Iran and the United Arab Emirates) to partner with a local company to start and develop a business.

3. **Key focal points for expanding internationally**

Contracts for the international sale of goods: The importance of governing law and jurisdiction clause

The sale contract sets out the agreement between the exporter and the importer. It can be entered into with a commercial agent, a distributor or an end-consumer.

Legally speaking, the choice of the governing law and the choice of the competent jurisdiction in case of a dispute between the parties is a fundamental issue that must be carefully addressed just like, for instance, payment terms, delivery terms or warranties.

This choice is not without consequences whenever it becomes necessary to construe the contract because a dispute arises.

Several international conventions provide insight on how these issues should be addressed in the context of an international contract.

- Choice of governing law between EU Member states: The so-called Rome I Regulation[1]:

Pursuant to this Regulation, **the parties are free to choose the law that will govern the contract**, provided notably that such choice does not prejudice the application of mandatory overriding legal provisions[2] [3].

In the absence of choice by the parties, the sale contract shall be governed by the law of the country where **the seller has his habitual residence**[4].

Wherever the governing law cannot be determined on this basis, the contract shall be governed by the law of the country with which it is **most closely connected**.

- Choice of governing law outside the European Union: The Hague Convention on the law applicable to international sales of goods:

The principle enshrined in The Hague Convention dated June 1, 1955 is that of contractual freedom.

If the parties have not chosen the applicable law, the Convention stipulates that the contract shall be governed by the law of the country in which the seller has his habitual residence or in which the seller's establishment that received the order is located.

- Choice of jurisdiction: The so-called Brussels I recast Regulation[5]:

Here also, the **principle** laid down by the Brussels I recast Regulation is that of contractual freedom since the parties may choose, when drafting the contract, to insert either a jurisdiction clause (i.e. to settle disputes in a court of law) or an arbitration clause (i.e. to settle disputes through an arbitration process).

In the absence of choice by the parties, the plaintiff may choose to bring its action:

(i) before the court of the place where the defendant is domiciled (Article 4 of the Brussels I recast Regulation); or

(ii) before the court of the place where the obligation in question (supply of goods or provision of services) has or is to be performed (Article 7 § 1, a) of the Brussels I recast Regulation).

Termination of the commercial agency contract: The issue of indemnification upon termination of the contract

The choice of the governing law in a commercial agency contract isa good illustration of the issues at stake in this respect.

Council Directive 86/653/EEC of December 18, 1986 sets forth the terms and conditions applicable to commercial agents in EU Member States.

As such, pursuant to this Directive, Member States were entitled to choose between two types of indemnities for the commercial agent upon termination of the agency contract, i.e.:

- The so-called "indemnification" regime[6] that takes into account the new customers brought by the commercial agent and limits the amount of indemnification to an indemnity of one year calculated from the commercial agent's average annual remuneration over the preceding five years.
- The so-called "compensation" regime[7] that aims at compensating the commercial agent for the loss suffered as a result of the termination of agency contract.

When the Directive was transposed into domestic law, **almost all the Member States opted for the regime provided for by Article 17.2 of the Directive**, i.e. the indemnification regime.

Only France and Ireland opted for the compensation regime.

Yet, according to French case-law, the indemnity likely to compensate the loss suffered by the commercial agent as a result of the termination of the agency contract is two years of commissions calculated on the average annual remuneration earned by the commercial over the preceding three years.

Consequently, a French exporter may wish to consider applying the law of the country of its agent, in particular if such agent is located in Germany insofar as under German law the indemnity due to the commercial agent in case of termination would be one year of commission, instead of two.

[1] Regulation EC n°593/2008

[2] Article 3 §4 of Regulation EC n°593/2008 known as “Rome I Regulation”

[3] Article 3§3 of Regulation EC n°593/2008 known as “Rome I Regulation”

[4] Article 4 of Regulation EC n°593/2008 known as “Rome I Regulation”

[5] Regulation EU n°1215/2012

[6] Article 17.2 of Council Directive 86/653/EEC on the coordination of the laws of the Member States relating to self-employed commercial agents

[7] Article 17.3 of Council Directive 86/653/EEC on the coordination of the laws of the Member States relating to self-employed commercial agents