



Legal and Cultural Framework Regarding Sales in Germany

Most U.S. companies selling their products into Germany will need some sort of sales and distribution mechanism, probably using a pre-existing German sales organization or even several of them. Although Germany is geographically small (about the size of Montana), it has many precisely defined regions with their own attitudes, peculiarities and business loyalties. Below is a list of legal points which may be surprising, a discussion of cultural aspects of marketing and finally a detailed discussion of the legal aspects.

German Legal Surprises -

1. The U.S. seller may retain title to the goods until sold. No special security filing is required.
2. The U.S. seller may restrict post termination activities of the sales organization but must pay a fee to enforce this restriction. The fee may be saved by waiving the restriction, but only after 6 months' notice.
3. As in the U.S., the U.S. seller may control the price at which a sales agent offers the goods, but not the price at which a distributor resells them.
4. The sales organization has a claim to post termination profits generated by his pre-termination activities.
5. The sale organization has a right to a separate fee for collecting the sales price.

Cultural Discussion -

Of course, sales in Germany are not only a matter of statutes and contracts. Centuries of trading and generations of manufacturing have created certain other realities which can be more important than the law. Indeed, most business problems in Germany are worked out over beers, late in the evening.

1. Germans seldom buy a product because it has a short term, low cost. Performance, durability and reliability are very important.
2. As a result of 1, the sales person has to be fully informed about the technical characteristics of the product. Sales are not made because the sales person has a nice smile or a big expense account. He must be prepared to defend the product against tough criticism. Probing, direct questions are a sign of interest.
3. Beyond the reliability of the product itself, the reliability of the manufacturer is essential. The goods must arrive on time, without constant inquiries. If the goods are custom made over months, progress reports are essential.

4. Germans do not simply expect a product to meet specifications but to perform, to produce, as promised. This may involve extensive installation activities, training and prompt post sale service. Lufthansa is not a tourist airline. Germany has those. It is a means of getting highly trained engineers to all points in the world where German equipment is in use. So the U.S. manufacturer should be prepared to send a competent technician to Germany to see that the equipment functions properly.
5. Germans are wary about American business practices, even mistrustful. Some of the reasons for this include:
 - a. Germans are in a tightly knit society and their reputations for honesty and reliability are highly prized. They permit German business to function without lengthy contracts and expensive lawyers. Disputes and suits do arise, but they are much rarer than in the U.S.
 - b. German law protects the rights of the creditor. German companies have to have minimum capital to be formed and have to make a public announcement if they become insolvent (a balance sheet test). In the U.S., our laws protect the shareholder.
 - c. Many Americans feel they have kept their promise if they intended to do so when they gave their word. In Germany, they perform, however difficult it may be. Not to do so is a breach unless due to an Act of God. German law also favors specific performance – fulfilling one's promise - over awarding damages.
 - d. In the U.S. if one party asks the other for something, often there is an expectation of an immediate quid pro quo. In Germany, if there is any quid pro quo, it is that the firm is reliable and its reputation is enhanced and a good business partner.
 - e. Germans are pessimists. This is a characteristic one wants in an engineer. Their projections are therefore conservative. They know Americans are optimists. This difference in world view can create tensions.
 - f. Germans put truth and directness before diplomacy, believing that the fact is the important issue and that personal emotions should not deflect the truth from being spoken. Direct speaking is seen in Germany as a sign of respect and a fundamental in the search for the correct answer to a particular problem.

This directness in communication style also manifests itself in a lack of self-deprecation and coded language. A charge of arrogance is sometimes leveled at German businessmen and, although there is great pride taken in German achievements, this perceived arrogance is more a misinterpretation of direct speech. A German will give a factual rendition of his/her own capabilities, which is not the same as arrogance. Germans are often disappointed when they hire Americans based on their resumes, which are puffed up compared to the German equivalent.

- g. German employment laws make firing employees very difficult. So if American optimism results in a German company staffing up, it cannot reduce that staff as easily and cheaply as in the U.S. Similarly, mid-sized German companies are often the largest employer in their town. The owner feels a special responsibility to his fellow citizens. Germans know that Americans can hire and fire more easily but are still shocked by this practice.
- h. Decisions in German businesses are often made by teams, based on consensus. So the decision making process may take longer than Americans expect.
- i. Despite being reliable and hard working, there is one big exception to this rule: vacations and holidays. Do not expect decisions during periods of religious holidays or August. School holidays are shorter and spread throughout the year. They are on a province by province basis so everyone in a particular factory may be gone at the same time. Voice mails and e-mails will go unanswered during these periods. Germans see this as part of their dedication to family.

1. Legal Discussion

There are five options for conducting sales in Germany:

- a) A *sales representative* is an independent businessman tasked long term – i.e. not ad hoc - with procuring business for a manufacturer. “Independent” means self employed - able to decide when and how he is going to fulfill his contractual obligations. Depending on their agreement, the sales representative may act as (i) an agent for the U.S. manufacturer, empowered to negotiate and enter into agreements on behalf of the producer or (ii) a person who solicits offers to purchase for the U.S. manufacturer, those offers being subject to acceptance by the manufacturer. Either way, a sales representative works in the name of and for the accounts of the manufacturer (for details see No. 2 below). (Art. 84 HGB)
- b) A *distributor* buys product from the manufacturer and resells it for its own account. (for details see No. 3 below).
- c) A *sales agent* procures business for the manufacturer but is not entrusted long term with procuring sales, just occasionally. He cannot bind the manufacturer and is not entitled to collect payments for the business he procures. If the sales agent arranges for a sale, he has a claim for remuneration as agreed upon in the sales agent agreement. (Art. 93 ff. HGB)

- d) A *permanent employee* of the U.S. manufacturer is charged with obtaining orders. Depending on the employee and the employment contract, the issue of which labor law (U.S.-American or German) is applicable could well arise.
- e) A *subsidiary* of the U.S. manufacturer may be formed to act either as an agent or a distributor.

Theoretically the U.S. manufacturer could set up a website and sell product directly to the end user in Germany, just like any other customer. Of these alternatives, the sales representative and the distributor are most similar to U.S. experience.

2. Details on sales representatives under German Law

The most important characteristics of a sales representative under German law are described below.

a) Sales representative's duties

A sales representative must make an effort to procure business and must act in the best interests of his principal. Duties arising from this aspect are e.g. the duty of discretion and non-competition and the duty to undertake solvency checks of the customer. Additionally the representative must keep the principal posted as to all relevant news concerning sales, usually within three days of any business procured and weekly or monthly regarding market development, depending on the trade. Both duties described above are mandatory and the law forbids any differing agreements. Furthermore he must act like a prudent businessman, i.e. give thoughtful advice to customers, quote prices and conditions of the manufacturer correctly and act in accordance with fair competition rules. (Art. 86 HGB)

b) Sales representative's rights, in particular commissions

WHAT

A Sales representative can claim a commission for all contracts entered into during the term of his agreement that were brought about by his efforts or entered into with clients that he has solicited for such business. He can also claim a commission for business generated in his area, if a specific geographical area has been assigned to him.

Additionally, a sales representative has a claim with regard to separate, additional collection commission if he does not simply obtain the order but also collects the payment. (Art. 87 HGB)

The sales representative cannot claim reimbursement for regular business expenses, except if in accordance with custom and usage. (Art. 87 d HGB)

WHEN

The claim for a commission arises when the procured purchaser enters into the contract with the principal; however, it will become invalid if it becomes clear that the purchaser will not pay or is bankrupt.

The sales representative and the principal may agree that the commission will be paid only after the purchaser has completely performed its duties under the procured contract (this is the latest possible time), but the sales representative has an unwaivable, statutory right to claim (and receive) a partial advance payment.

If the nonperformance is caused by the principal, e.g. if he does not deliver the goods or delivers different or damaged goods, the agent still has a statutorily protected right to his commission. (Art. 87 a HGB) But the principal is not obligated to enter into agreements procured by the sales representative.

HOW MUCH

If the amount of the commission is not agreed upon, a usual amount for that type of business is payable. Generally, commission claims must be calculated monthly, latest every third month. If long term contracts are procured, the commission will be calculated for the whole term of the contract, but is payable as provided above. If the period of the contract is not specified, the commission will be calculated on the base of the contract term up to the first possible termination date for the purchaser.

The sales representative may require disclosure of an extract of the financial records of the principal concerning the relevant business and all other information relevant to the calculation of his commission claim. If there are obscurities or the principal refuses to provide the relevant extract, the sales representative may require a certified accountant to check the books with respect to the correctness of the calculation of the commission. These rights cannot be waived or limited. (Art. 87 b, c HGB)

COMMISSION CLAIMS AFTER TERMINATION

After the sales representative agreement has ended, the sales representative can still claim a commission (1) for contracts he procured, (2) contracts he initiated to the point where the execution of the deal was mostly due to his efforts, (3) if the contract has been entered into within an adequate period after the contractual relationship between the sales representative agreement and the principal was terminated or (4) if the offer for entering into an agreement by a purchaser, concerning which the sales

representative would have been able to claim commission, has reached the sales representative or the principal before the termination. (Art. 87 HGB)

FORMALITIES

Both parties have a statutory right for the contract to be documented and signed by the other party, be it the original agreement or subsequent amendments. (Art. 85 HGB)

POST SALE SUPPORT

The German Commercial Code does not make the sales representative responsible for customer liaison or support. The concept of the German Commercial Code is that of a sales and marketing person winning new purchasers and procuring sales for the principal. However, in real life this might not be practicable because the purchaser may expect certain services from the sales representative. In such cases, the parties may agree that the sales representative receives some compensation for providing such support services.

c) Principal's rights and duties

The principal must provide all documents and information necessary for the sales representative to carry out his tasks, e.g. samples, designs, price lists, advertising materials and business terms and conditions. He has to inform the sales representative of all relevant news, especially about the acceptance or refusal of contracts procured or entered into by the sales representative in the name of the principal or its nonperformance. The principal also must by law inform the sales representative if he can or will only enter into agreements of considerably smaller volume than the sales representative could have expected under usual circumstances. (Art. 86 a HGB)

If the sales representative is not authorized to enter into contracts or has restricted authority for certain contracts for the principal, the contracts he enters into in the name of the principal will still be enforceable against the principal if he does not immediately reject the agreement after he received notice of the contract. (Art. 91 a HGB)

d) Termination of sales representative agreement

If the sales representative contract is entered into for an unlimited period of time, it can be terminated on one month's notice within the first year, two months' within the second year and three months' in the third to the fifth year. After the fifth year, the termination period is six months. (Art. 89 HGB)

Termination without a notice period is possible at any time if a party materially breaches his contractual duties. If termination has been caused by actions of the other party, that party is liable for the damages resulting from the termination. (Art. 89 a HGB)

The sales representative has a right to remuneration after the termination of the agreement if the principal still enjoys the benefit of new client business relations developed by the sales representative. This rule also applies to business relations the sales representative materially developed in a way comparable to the recruiting a new client. This payment is capped at the sales representative's average annual commission of the last five years or, if the contractual relationships has been shorter, the annual average during the term of the contractual relationship.

This claim does not arise if (1) the sales representative terminated the agreement, as long as this has not been caused by the principal or is not due to the age or lengthy incapacity of the sales representative; (2) the principal terminated the agreement due to a material breach by the sales representative; or (3) a third person substitutes the former sales representative in accordance with an agreement between the principal and the sales representative. These claims cannot be waived in advance and must be enforced within one year of the termination of the contractual relationship between the sales representative and the principal. (Art. 89 b HGB)

e) Confidentiality

The sales representative may not use or disclose business secrets he has been entrusted with by the principal or which he learned about during the course of the contractual relationship if incompatible with the professional ethics of a prudent businessman under similar circumstances. This obligation derives from the duty of the sales representative to act in the best interests of the principal during the term of the contractual relationship and includes, among others, knowledge about the business, production processes and customer relations of the principal. Secret information means any information about the business of the principal not publicly known if there is an economic interest in keeping it secret (Art. 86 HGB).

This duty survives the termination of the contractual relationship between sales representative and original principal but it becomes less strict after the termination due to the legitimate interest of the sales representative in conducting further commercial operations for other principals. (Art. 90 HGB)

f) Restraint of competition

If the sales representative and the principal agree upon a restraint of competition agreement for the sales representative, the restriction must be in writing, signed by the sales representative. It cannot cover (1) a longer period than two years after the termination of the contractual relationships, (2) a geographical area or client base other than the one the sales representative was in charge of during the contractual relationship and (3) other products than the sales representative was procuring business

for. The principal must provide the sale representative adequate consideration for the term of the restraint of competition.

The principal can give six months' notice of its waiver of its rights under the restraint of competition agreement any time within the term of the contract or the restrictive period contract and will thereupon be released from the duty to pay compensation. The parties can also terminate the agreement for an important reason (material breach) on one month's notice if the other party has intentionally violated its terms.

These provisions with respect to restraint of competition are mandatory and cannot be changed to the disadvantage of the sales representative. (Art. 90 a HGB)

3. Details on distributor

The distributor sells the goods in his own name and for his own account and also provides post sale support services. In general, only the normal German rules of sales and purchase agreements apply; however, if the obligations of the distributor are structurally similar to those of a sales representative, the courts may apply some of the provisions described above *mutatis mutandis* to a distributor (e.g. regarding termination of the contract and remuneration for profits after the end of the contract).

If the distributor prefers the option of returning unsold goods to the principal, a sale on commission (in the name of the distributor but for the accounts of the principal) can be an advantageous variation. (Art. 383 ff. HGB) Apart from that, after the distributor has bought the goods from the manufacturer, there is no right or duty to return unsold goods at the end of the contractual relationship, however, such a provision can be agreed upon in the sales distributor contract.

A minimum sales requirement can be part of the sales distributor contract if it clearly states the requirement. If the distributor does not comply with this obligation, he may be terminated and held liable for damages.

The distributor may use the name and advertising material of the manufacturer only to the extent permitted by the contract with the manufacturer.

Under German law, a title retention clause can be agreed upon in a sales agreement as security for the seller. The effect is that title to the sold goods remains with the seller until certain conditions are fulfilled, for example the complete payment of the purchase price.

The necessary stock of goods and spare parts can be owned either by the distributor or by the manufacturer and only managed by the distributor. Title to goods stored in Germany will be subject to German Law pursuant to Art. 43 EGBGB (applicable is the law of the country the object is situated in).

In general, goods imported into Germany to be sold will be subject to customs duties. Applicability and amount differ according to the type of goods in question. The value of the goods will be higher (and so customs duties higher) if the goods are sold to the end user and not the distributor. This is because the price to the distributor has to be low enough for the distributor to mark it up and thereby make his profit. As in the U.S. the distributor has the goods on his balance sheet and bears the risk of loss.

4. Exclusivity

An important aspect of the relationship is exclusivity, both for the independent distributor and the sales representative.

The manufacturer will want to limit the other party's right to sell competitive products. While it is not possible to limit distributor/representative's other selling activities altogether, the manufacturer can prohibit the sale of similar products or products that serve the same purpose. This is codified in 60 HGB for employees, but also applies to other persons like sales representatives as an analogy.

Nonetheless, the contract should clarify exactly what the distributor/representative is allowed to do and what he has agreed to refrain from. This depends heavily on the type of product. For example, a tire manufacturer will be able to prevent its sales representative from selling tires from another brand, but not from selling exhaust pipes. In other cases the distinction can be more difficult, i.e. is outdoor clothing in competition with haute couture fashion? Although both serve different purposes, fashion changes fast and tension could arise. The contract should make it clear what exactly is permitted.

But the distributor/representative might want exclusivity for himself as well. He might want to be the only person to sell this product in Germany or in a part of Germany. This can create problems for the manufacturer if things do not run well and it wants to change the distributor or sales representative.

5. Jurisdiction

The parties can agree in the contract upon the jurisdiction for settling legal disputes. In case of a legal dispute, the case might be heard by a specialized Chamber for Commercial Disputes of the District Court if requested in the complaint (if the parties are businesses or the subject matter is a trade matter). The Chamber sits with one regular judge and two lay judges with a business background. (Art. 95 f. GVG)

With the help and comments of Annika Sunderdiek and Tim Montag, German trainees, and Sven Kill, a German trained attorney in Pittsburgh and Ulrich Philippi, an attorney in Stuttgart at Luther & Partner.