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European Bail-In Rules Extend to the US Credit Market

The new bail-in rules that generally took effect in January 2016 are the European Union’s response to the 2008 global financial crisis and the “too big to fail” regime. The EU Bank Recovery and Resolution Directive (2014/59/EU) requires that EU member states implement a similar legal framework whereby failing financial institutions will not look to public stakeholders for a “bail-out.” European regulatory authorities can force these failing institutions to cancel or severely dilute shareholder equity or to cancel, write-down or convert unsecured liabilities to equity. Such regulatory action is referred to as a “bail-in.”

The EU regulators were concerned about the effectiveness of the bail-in powers in contracts governed by the law of a country outside the EU. Accordingly, Article 55 of the bail-in rules mandate that for contracts governed by non-EU law the covered EU institution must give notice to their counterparties that liabilities arising under their agreement are potentially subject to write-downs or other regulatory action in a bail-in. The counterparty must also formally acknowledge such notice and the regulator’s power in a bail-in.

Many participants in the US credit markets will need to comply with the bail-in rules, including EU banks, EU investment funds and related subsidiaries and holding companies. An extensive range of contractual obligations may be affected by the rules. For example, the New York branch of a German bank providing financing under a US loan agreement governed by New York law will be required to notify the borrower that its funding obligations, including unfunded commitments and letters of credit, may be cancelled by its regulator. Because of the broad scope of Article 55, a German bank serving only an administrative role in a US loan agreement after selling off its lending exposure would also still be required to notify the borrower in accordance with the bail-in rules. Article 55 applies to potential contractual and non-contractual liabilities, including indemnities, confidentiality duties and documentation responsibilities. Thus, for US-governed loan agreements, Article 55 places affirmative responsibilities on an EU financial institution party to such document in almost any capacity.

In December 2015, the Loan Syndications and Trading Association (LSTA) issued model language to help EU financial institutions ensure that they are in compliance with the bail-in provisions for New York law-governed credit agreements. The Loan Market Association (LMA) issued similar provisions for use in credit agreements in the European loan market.

European loan market participants should consult their lawyers to determine which specific transactions will be subject to the bail-in rules, when they must satisfy the



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applicable regulatory requirements and, if necessary, how to incorporate the LSTA or LMA model language into their credit agreement. Non-EU counterparties should remember that many institutional investors heavily weigh the secondary trading of any loan when deciding whether or not to lend or participate in a loan. To the extent such non-EU counterparties comply with the bail-in provisions, the resulting liquidity can improve the value of the loan for all involved.





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Adidas Successfully Blasted the Registration of Parallel Stripes on Sport Shoes as a Community Trademark

In Case C-396/15 P of 17 February 2016 the Court of Justice of the European Union rules in favor of Adidas AG in a dispute of Shoe Branding Europe BVBA v Adidas AG. The Belgian company Shoe Branding Europe filed an application for registration of a Community trade mark with the Office for Harmonization in the Internal Market OHIM for the goods “Footwear”. The mark is depicted below:



Adidas filed a notice of opposition supported by the ground of likelihood of confusion which was based on their earlier right, the Community figurative mark which is reproduced below:



The Opposition Division rejected the opposition and adidas filed an appeal with OHIM against the Opposition Division’s decision. The Second Board of Appeal of OHIM dismissed the appeal, because the differences in the number of stripes and their respective positions on the shoe were sufficient to find that the signs at issue were, overall, dissimilar and any likelihood of confusion could be precluded, even for identical goods.

Thereafter adidas brought before the General Court an action seeking the annulment of the contested decision and the General Court annulled the contested decision.

Finally Shoe Branding filed an appeal with the Court of Justice claiming that the Court should set aside the judgment under appeal and confirm the contested decision.

With its order of 17 February 2016 the Court of Justice upholds the General Court’s judgment.

The Court of Justice explained that the minor differences between the signs at issue



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Adidas Successfully Blasted the Registration of Parallel Stripes on Sport Shoes as a Community Trademark

like the different length of the stripes resulting from different angles would not influence the overall impression produced by them on account of the presence of wide sloping stripes on the side of the shoe. Therefore the General Court was right in this regard and the OHIM decision was not properly reasoned. Further the Court of Justice held, in accordance with the General Court, that the differences in the number and the length of stripes were not sufficient to affect the similarities arising from the configuration of the signs at issue.

As a consequence the Community trademark application of Shoe Branding Europe will be rejected.



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Product Liability Litigation in the United States: Defending Against Claims on Multiple Fronts

When a German company sells its products in the U.S., those products can theoretically end up in more than 50 U.S. jurisdictions. As product liability law in the U.S. is, for the most part, a matter of state law (as opposed to federal law), the assessment of product liability claims is complex and requires a thorough understanding of the distinctions in the law from one state to the next. German companies must work closely with their designated counsel in developing a successful strategy in the defense of product liability cases pending in different courts across the country.

Product liability claims can arise under a number of theories, including:

- express and implied warranties
- violations of consumer protection statutes
- negligence
- strict liability

The burden of proof and permissible defenses for each claim vary greatly from state to state. The differences in the law are most prevalent in the context of strict liability claims for alleged product defects.

Strict liability claims focus on the product itself and not the conduct of the manufacturer. Thus, liability may attach even if the manufacturer or supplier has taken every possible precaution. In most states, strict liability claims arise under one of three theories:

1. manufacturing defect
2. design defect
3. defective or inadequate warnings

Regardless of the theory, a plaintiff must generally establish that the product contained a defect at the time it left the custody or control of the manufacturer/supplier, that there was no substantial change to the product, and that the alleged defect was the proximate cause of the alleged injuries. Most strict liability cases pending in courts in the U.S. allege that warnings were inadequate.

A manufacturing defect involves a flaw in the manufacturing process and requires proof that the product deviated in a material way from the design specifications, formula, or performance standards. The analysis of *manufacturing* defects is fairly consistent from state to state, but a fifty-state analysis of the applicable law in design defect and failure to warn claims is far more complex. Design defects require proof that the design

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itself was somehow flawed. Some states now require proof of a feasible alternative design, but others permit recovery based solely on the fact (if proven) that the design rendered the product dangerous to an extent beyond that which would be contemplated by the ordinary consumer. In a “failure to warn” claim, the focus is on inherent dangers foreseeable at the time of manufacture or distribution.

“Design defect” and “failure to warn” claims focus on the product as originally designed and distributed and, as such, require consideration of what the defendant knew and what technology was available at that time. But some courts exclude this type of evidence on the ground that evidence of fault (i.e., negligence) is irrelevant to a strict liability analysis. As a result, there are gross inconsistencies in rulings from the trial courts. Additional state law distinctions complicating the evaluation include: (1) whether the product/warning is viewed based on the knowledge/technology available at the time of injury or trial, as opposed to the time the product was manufactured; (2) whether evidence that a product was “state of the art” is admissible; (3) whether expert testimony is required to establish a defect and/or causation; and (4) whether the burden of proof shifts to the defendant for some elements of the claim.

Counsel must not only know the law but also fully understand how a product was designed, manufactured, labeled, packaged, marketed, and sold. While that learning process can initially take considerable time and resources because it requires a comprehensive review counsel can more effectively manage the litigation once the information is conveyed.

German companies selling their products in the United States should involve experienced product liability counsel early on to help prepare the products for the U.S. market and, thus, possibly prevent problems down the line. When claims are brought against the company, experienced counsel can also help avoid major problems that could arise from the application of different laws in the many different jurisdictions in the United States.



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PATH Act Makes Major Changes to FIRPTA

The “PATH Act,” (short for “Protecting Americans from Tax Hikes Act of 2015”) enacted December 18, 2015, made permanent, or extended, most of the Code provisions that for many years have had built-in expiration dates. But it does more. The PATH Act (which makes extensive changes to the treatment of real estate investment trusts (REITs)) includes major changes to Code section 897 (the “Foreign Investment in Real Property Tax Act of 1980” or FIRPTA) and section 1445 (the withholding rules for enforcing FIRPTA), not all of which are limited to foreign shareholders of REITs. Because of the PATH Act:

- Funds exempt from FIRPTA – FIRPTA is now inapplicable to United States real property interests (USRPIs) held by “qualified foreign pension funds.”
- Publicly traded REIT stock excluded from USRPI – The percentage of publicly traded REIT stock that a person can hold without the stock being treated as a USRPI with respect to that person has been increased from 5% to 10%.

In addition the following changes are included:

- Withholding rate increased – The general withholding tax rate on the proceeds of dispositions and distributions of USRPIs (historically, 10%) will increase to 15%. The increase in the withholding rate will only apply to dispositions after February 16, 2016.
- Cleansing rule repealed for REITs or RICs – The holder of the stock of a corporation that is or has been a REIT or a regulated investment company (RIC) can no longer treat the stock as “cleansed” of its USRPI status once the REIT or RIC sells all of its USRPIs.

With some exceptions, the United States generally taxes nonresident alien individuals and foreign corporations on their gains from sales or exchanges of property if and only if the gains are effectively connected with the conduct of a trade or business in the United States (“effectively connected income” or ECI). However, FIRPTA automatically deems the gains of such persons from the disposition of USRPIs to be ECI, regardless of whether the person actually engaged in any U.S. trade or business.

The term “USRPI” encompasses not only an interest (other than solely as a creditor) in real property located in the United States, but also stock of a domestic corporation (or other interest in the corporation other than solely as a creditor), unless the taxpayer establishes that the corporation was not a U.S. real property holding corporation (USRPHC) at any time during the shorter of the five-year period ending on the date of disposition or the period during which the taxpayer held the stock of the corporation (the “relevant holding period”).



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When a foreign person disposes of a USRPI, the transferee of the USRPI has generally been required to deduct and withhold a tax equal, until the PATH Act, to 10% of the amount realized on the disposition. Ever since the FIRPTA withholding rule, section 1445, was enacted in 1984, the rate of withholding has generally been 10%. That is, absent an exception, a transferee of a USRPI was generally required to deduct and withhold a tax equal to 10% of the amount realized by the transferor on the disposition if the transferor is a foreign person. The PATH Act increased the 10% rate to 15%, effective for dispositions that occur more than 60 days after enactment, or after February 16, 2016.

However, the legislation makes an exception for property (i) which is acquired by the transferee for use as a residence and (ii) where the amount realized upon disposition is greater than \$300,000 but does not exceed \$1,000,000. In these cases, FIRPTA withholding will remain at 10%.

For the most part, the PATH Act seems to represent a significant simplification for foreign investors in REIT stock and RIC stock, as well as provide a significant benefit for qualified foreign pension funds owning U.S. real property interests of all kinds. There are, however, plenty of new questions raised by the words added to the Code by the PATH Act. For this reason, several definitions are hopefully to be clarified in the future as taxpayers and the IRS grapple with these new provisions.



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Protecting Americans from Tax Hikes – Legislation for 2016 and Beyond

Every year there are always questions about whether or not Congress will extend or modify those tax provisions that are set to expire or change in some way. By the end of 2015, Congress did enact several changes to the tax law in legislation entitled “Protecting American from Tax Hikes” referred to as PATH. Some changes extended the provision, while other provisions were made permanent. Some of the important changes will be discussed below.

Depreciation

Bonus Depreciation extended through 2019

The bonus depreciation provision of the Internal Revenue Code that allow businesses to immediately deduct 50 percent of certain investments has been extended through 2019. However, the amount of expense deductible will be reduced to 40 percent in 2018 and 30 percent in 2019. After 2019 there will be no more bonus depreciation allowed without additional congressional legislation.

Section 179 increased deduction made permanent

Section 179 of the Internal Revenue Code allows the cost of tangible personal property to be expensed in the year of purchase, with some limitations and exceptions. The limits were set to return to previous amounts of \$25,000 of deductions beginning on January 1, 2015. However, PATH increased the deduction in 2015 to \$500,000 and made this amount permanent, with annual adjustments for inflation in future years. There is a spending cap of \$2,000,000 (the cap was slated to be \$200,000 prior to PATH); after a taxpayer spends this amount on equipment purchases, any Section 179 deduction will be reduced dollar for dollar.

Other Business Credit Extensions

The research credit is retroactively restored and permanently extended. Beginning in 2016, the credit may also be used to offset the taxpayer’s alternative minimum tax liability.

The New Markets Credit was extended through 2019.

Changes and Extensions that Affect Individual Taxpayers

Tax Free Charitable Donations from IRA accounts

PATH has made permanent the provision that allows taxpayers aged 70 1/2 and older to make tax-free donations directly from IRA accounts. This enables the taxpayer to transfer



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a required minimum distribution of up to \$100,000 tax free (\$200,000 if both spouses have IRAs) to a qualified charity without paying taxes on the amount.

State and Local Sales Tax Deduction

This deduction that allows for state and local sales tax to be deducted on federal tax returns was slated to expire after 2014. However, PATH made the deduction retroactive and permanent. The sales tax deduction is taken only if greater than the state income tax deduction would be. Actual sales tax expenses may be used or optional tables can be used with some additions for certain large purchases such as automobiles.

Withholding Rate on FIRPTA Distributions

Not all of the changes made by the PATH bill were favorable to individuals. An important change that affects nonresidents with real property interests in the U.S. was that the Act increased the withholding rate from 10 percent of the gross selling price to 15 percent for those dispositions that occurred 60 days or more after December 18, 2015. The 10 percent rate will still be effective for those taxpayers who sell personal residences that do not exceed one million dollars.





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Quality Assurance Agreement vs. Supply Agreement?

In supply chains, Quality Assurance Agreements are a frequent requirement between the Manufacturer and its Suppliers. This is specifically true of safety related sectors. Quality Agreements are standard in the automotive, aeronautic, medical devices, pharmaceutical and food industries, to mention only some. And they become more and more common in other sectors because they raise the degree of reliability in just-in-time supply chains and are said to improve cost efficiency. In some industries, Quality Agreements are a requirement set by regulatory bodies, in others they just serve as guidelines between the parties in their day-to-day business.

It seems, however, that Quality Agreements are often wrongfully considered to be more important than a Supply Agreement. The classical distinction between Supply Agreements (primarily commercial and legal issues) and Quality Agreement (product quality and manufacturing process related issues) is many times blurred. Quality Agreements often take the lead in supply relationships. To some extent, this is due to the fact that more and more agreements are drafted and negotiated by quality or procurement departments while in-house or external counsels are not involved at all. Thus, we have seen that Quality Agreements are sometimes completely disconnected from the Supply Agreement, or even stand alone.

This can lead to difficult and hazardous situations. For the sake of legal security it is of great importance to (i) maintain the distinction between Supply Agreement and Quality Agreement, to (ii) draft them in separate documents, but to (iii) link them to each other.

Supply Agreements are essential in a business relationship that reaches beyond a mere seller-purchaser relationship. They typically contain the core commercial and legal clauses such like product specification, price and payment conditions, delivery terms (e.g. INCOTERMS), clauses relating to limitation of certain liabilities, the applicable law and jurisdiction. Quality Agreements define details relating to the manufacturing process. They stipulate the observance of manufacturing standards, like specific ISO rules; they establish responsibilities of the parties regarding quality control for outgoing or incoming products, traceability of goods along the production chain, right of the Manufacturer to audit the Supplier’s production facilities, sharing of responsibilities in recall situations. Quality Agreements and Supply Agreements can overlap in various of the aforementioned points but they typically do when it comes to define the consequences of product defects. Non-conforming or defective goods logically create a quality problem (resulting, for example, in predefined corrective and preventive actions, or “CAPA”) but without any doubt they also have their legal impact (consequences of



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Quality Assurance Agreement vs. Supply Agreement?

supply of non-conforming or defective products; damage claims and product liability issues, etc.). Therefore it is essential to draft both Supply and Quality Agreements with care, to make references between them and to harmonize those topics which affect both legal and quality issues.

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