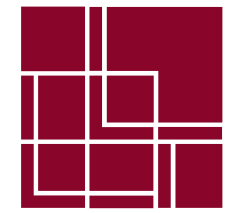


Legal Issues Surrounding Destination Restrictions in Taiwan and Way Forward

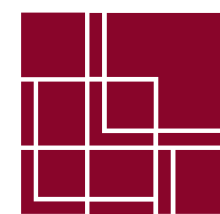


Patrick Marros Chu
Partner
Lee and Li, Attorneys-at-Law
July 9, 2019



Two Main Issues

- **What destination clauses and profit share clauses may constitute violations under Taiwan competition laws?**
- **How can the model diversion clause be implemented in Taiwan?**



Index



The LNG market in Taiwan



Brief introduction of Taiwan Fair Trade Laws



Responses to the main issues



Prospect

LNG importation for Taiwan

- Currently there are two liquefied natural gas (LNG) import terminals built by CPC, a state-owned energy company and the only LNG importer in Taiwan. CPC is planning to start building its third LNG import terminal after it obtains all the required permits.
- In addition, TaiPower prepares to build the infrastructure necessary for Taiwan to make optimum use of increased LNG imports, including plans for two new LNG receiving terminals. Accordingly, it is expected that there will be 5 terminals in Taiwan in the coming 10 years.
- Taiwan is one of the world's largest LNG importers with an import volume of 16.8 million tons per year (tpy) in 2018. The island is boosting its LNG imports as it plans to phase out nuclear and coal to generate electricity in the next decade.
- According to the public information, Taiwan procures much of its LNG through long-term contracts, primarily from Qatar, the world leader in LNG, which supplies Taiwan through joint ventures. Imports also come from Australia, Papua New Guinea, Malaysia and Indonesia.
- To diversify supplies, CPC will start receiving LNG from the United States in 2021 after CPC inked a 25-year deal with Cheniere Energy in 2018. CPC is also eyeing new supplies from Russia's Sakhalin island in the Pacific, or the U.S. state of Alaska and may seek joint purchases with other buyers from Japan and South Korea.



The state-owned company, CPC Corp., is Taiwan's only natural-gas importer.
It currently operates two LNG receiving terminals.
(Source: CPC's website)

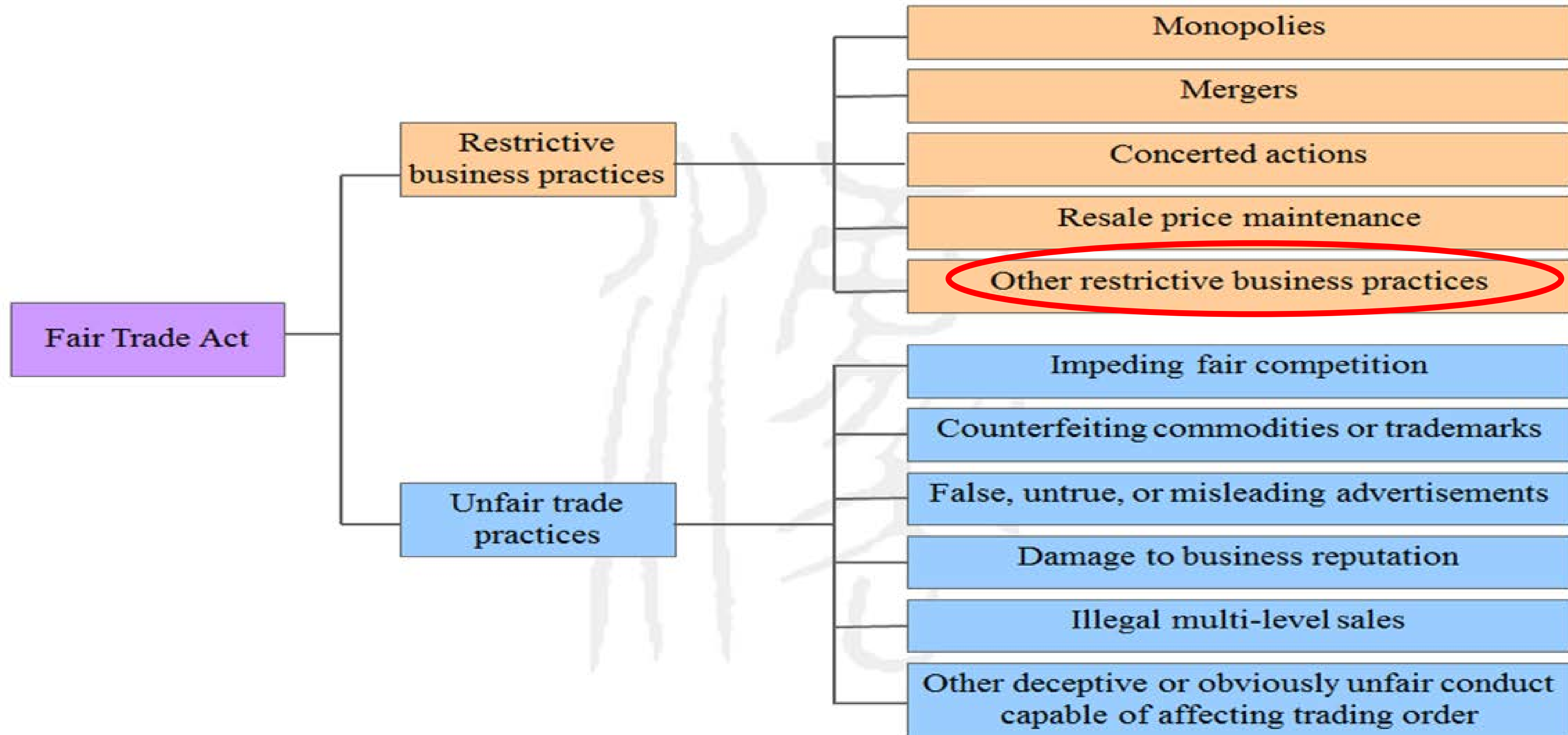


Taiwan's first terminal built in Kaohsiung
(Source: CPC' Newsletter)



Taiwan's Second terminal built in Taichung
(Source: CTIC's website)

Introduction of Taiwan Fair Trade Laws



Limiting Trading Counterparties' Business Activity Improperly

1. Definition

- Definition - limiting trading counterparties' business activity **improperly** by means of the requirements of business engagement
- ✂ **Key: Reasonable restrictions are permitted (Rule of Reason).**
- Restrictions - including tie-ins, exclusive dealing, **restriction on territory**, customers, use, or **other activities**
- In determining whether the restrictions are reasonable, the totality of such factors as **the intent, purposes, and market position of the parties, the structure of the market to which they belong, the characteristics of the goods, and the impact that carrying out such restrictions would have on market competition** shall be considered.
- Lack of case precedents on LNG related cases in Taiwan.



(Source: CPC's website)



Limiting Trading Counterparties' Business Activity Improperly

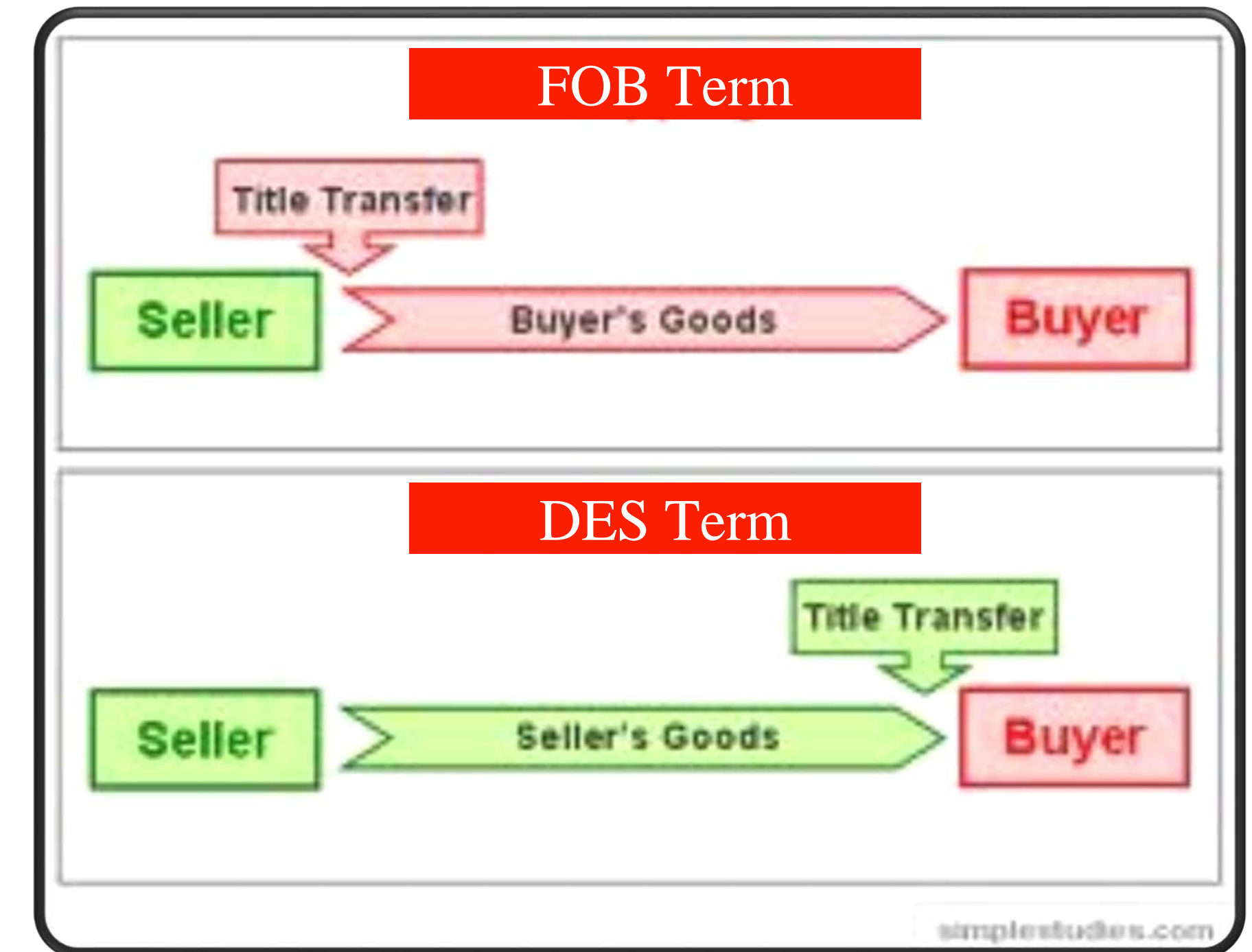
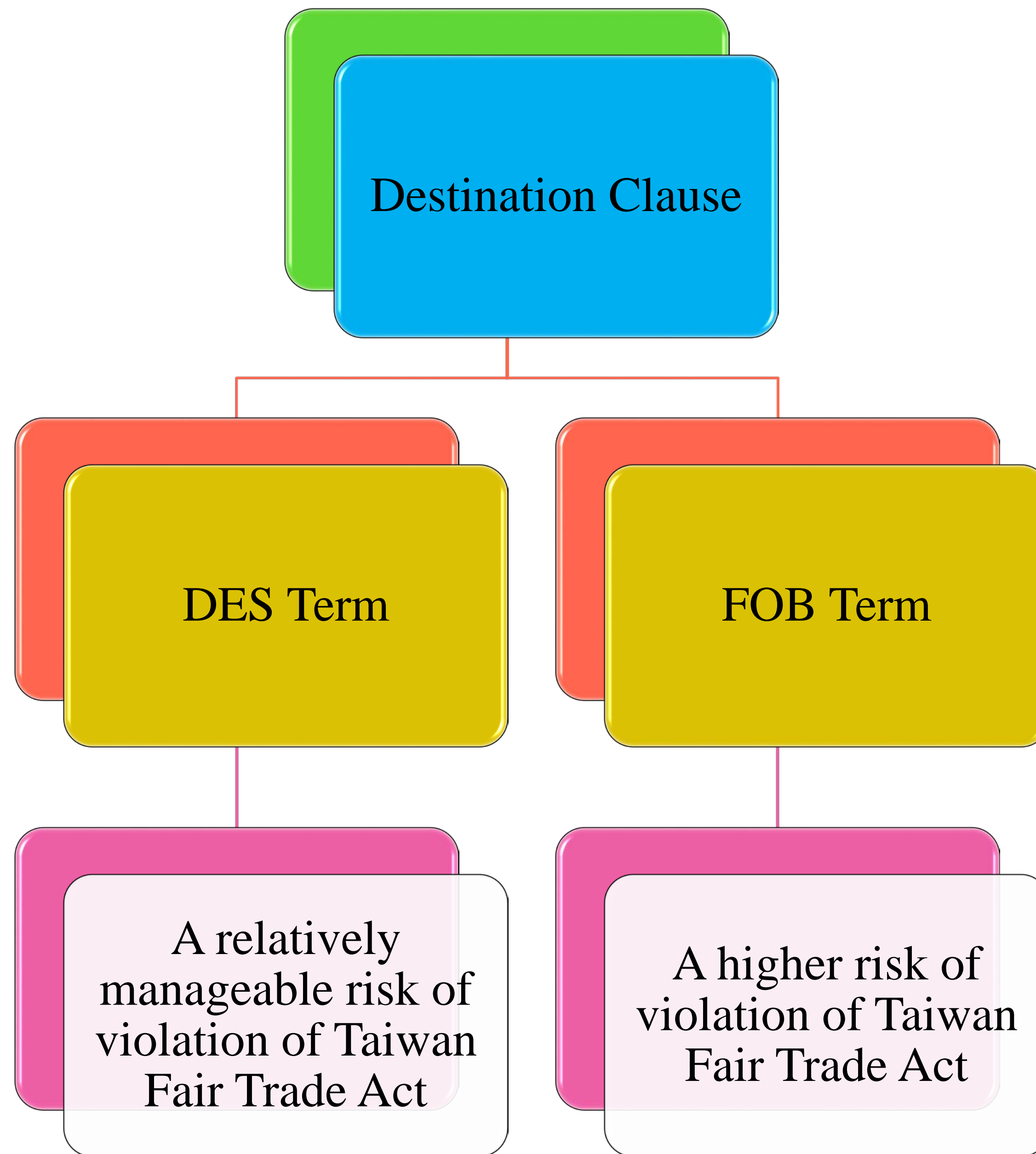
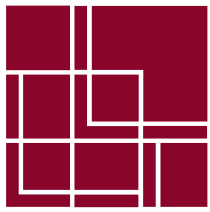
Some Case Precedents

- ◆ Hutia Motor set restrictions on the distribution territories of its distributors — a fine of NT\$3 million (2012/3/29)
- ◆ Merida prohibited its reseller to resell its products online, and refused to provide warranties for such products — a fine of NT\$2 million (2012/3/29)
- ◆ Hong Ying and Rue Ying restricted their distributors from becoming agents, brokers or distributors of other brands of MIDI products — a fine of NT\$700,000 and NT\$1,000,000 respectively (2010/07/06)
- ◆ Pacific Sogo Department Stores added territorial restriction on the boutique's operation in the boutique rental agreement, which was drawn up unilaterally by Pacific Sogo — a fine of NT\$2,500,000 (2002/05/24)

Limiting Trading Counterparties' Business Activity Improperly

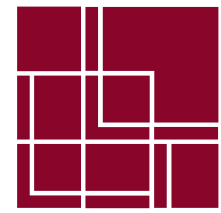
Consequences of Violation

- **Administrative Penalty – fines + cease and desist order + imposed consecutively**
- **Criminal Penalty – continuous or repeated non-compliance**
- **Civil Liabilities**
 - ◆ **Claims for removal or prevention of infringement**
 - ◆ **Claims for damages**
 - ◆ **Punitive damages – up to three times**



Source: Howtoexportimport.com





Destination Clause

Under a DES contract

Given that the deliver point is an unloading terminal and the seller is responsible for transportation to the unloading terminal, there may be certain reasonable grounds (e.g., shipping costs) for the destination clause → A relatively lower risk of being deemed as limiting trading counterparties' business activity improperly.

Under a FOB contract

Given that the deliver point is a loading terminal and the buyer is responsible for transportation from the loading terminal, there would be a higher risk of being deemed as limiting trading counterparties' business activity improperly.



Profit Sharing Clause

- A disincentive for the buyer to divert cargo from one place to another → potentially distorting competition (which may be regarded as limiting trading counterparties' business activity improperly)
- Under the Taiwan Fair Trade Act, **whether a restriction is reasonable will be determined on a case by case basis**, depending on the totality of such factors as the intent, purposes, and market position of the parties, the structure of the market to which they belong, the characteristics of the goods, and the impact that carrying out such restrictions would have on market competition.
- In the absence of case precedents, if a profit sharing clause is to be adopted in a LNG SPA, to mitigate the risk:
 - A **Reasonable Restriction on** profit sharing percentage/amount
 - A **Reasonable Restriction on** scope of diversion (e.g., diversion among countries, not within a country)



Prospect – Flexibility for Buyers



Given that currently there is only one LNG importer in Taiwan (i.e., CPC), it is less likely that the destination clause will restrict competition in Taiwan.



Profit sharing clauses that do not limit the resale price are more likely to be permitted under the Taiwan Fair Trade Act.



Since (i) the LNG market is likely to remain in favor of buyer until 2020; (ii) the nuclear free policy leads to the increase of the LNG demand; and (iii) CPC is expanding its suppliers around the world, the destination clause and the profit sharing clause will less likely be an issue under Taiwan law.



Thank You For Your Attention