Distribution agreements: The cost of termination – statutory compensation and other consequences of termination

Claudio ARTURO
Vienna, Austria

David PINET
Paris, France
Scope and content of the presentation

Termination of “distribution agreements” in the narrow sense of the word, i.e. agency or franchising agreements are not covered by this presentation

1. Overview on different systems of compensation
2. Statutory provisions and other consequences
3. Systems for recognizing indemnity or compensation for “insufficient” term of notice to Distributors
4. Other consequences of termination
1. Systems of compensation

1.1. Goodwill indemnity
e.g. Austria, Germany and Spain – applies by analogy in all these countries
Distributor is entitled to receive an indemnity for losses of the commission equivalent to the advantage of Principal

1.2. Indemnifications - Damages
e.g. France
Distributor is entitled to receive compensation for damages if the contract or the law has been breached

1.3. Investment compensation
e.g. Austria, Belgium, The Netherlands

1.4. No compensation at all
e.g. Italy – if not otherwise agreed upon in the contract
2. Statutory provisions and other consequences

Compensation for investments / example: Austria

• Distributors are entitled to claim non amortized or non adequately utilizable investments they were obliged to make according to the distributorship agreement with regard to a uniform distribution

• Art 454 UGB – Austrian Commercial Code
• legislator had in mind when enacting this law: protection of car distributors (high investments: staff, showrooms, obligation to buy cars to present, etc.)
• prerequisites: only applicable for Distributors that are part of a “vertical distribution system”
• no compensation is granted if Distributor terminated without an important reason or Supplier terminated for an important reason
• no compensation is granted if Distributor transferred the contractual rights and duties to a third party → no case of termination
• within one year after termination Distributor has to notify principle about his claim, in order to avoid statute of limitation
• a possible goodwill indemnity claim (if applicable) remains unaffected
2. Statutory provisions and other consequences

Analogy of the agents’ indemnity to Distributors / example: Austria

- challenge in Austria: no standard definition of a distributorship agreement in the law
- typical understanding of a distributorship agreement is:
  - Distributor buys and sells products from Principal for own account
  - certain level of integration in the distribution organisation, more than simple buyer - seller relationship
- in principle rules for commercial agents do not apply analogically to Distributors
- exception: goodwill indemnity if Distributor is integrated at a very high level (see next slide) in distribution organisation of Principal + leaves certain amount of customers after termination
2. Statutory provisions and other consequences
Analogy of the agents’ indemnity to Distributors / example: Austria

The criteria for analogue application of a commercial agent’s goodwill indemnity to Distributors are the following:

1. Distributor has an obligation to promote sales and to purchase a certain amount of goods
2. Distributor has an obligation to keep a certain sales- and customer service organisation and an adequate stock
3. Distributor has to take part in the launch of new products
4. Principal has a right to give binding instructions to Distributor
5. A non-competition clause in favour of Principal is part of the agreement
6. Principal has a right to access the business premises of Distributor and its business records
7. Distributor is integrated in the distribution organisation of Principal in a way that he fulfils tasks comparable to a commercial agent and leaves a customer base after the termination of the contract
8. The sales margin Distributor could gain in this distributorship relationship did not already cover the increased value of the goodwill that remains with Principal

WARNING! Franchise Agreement just another form of distributorship agreement

A goodwill indemnity claim through analogy is applicable under the same circumstances as for other Distributors → a typical Franchise Agreement will usually fulfil the prerequisites for an analogy in Austria
2. Statutory provisions and other consequences

France: No specific statutory provision for Distributors regarding a goodwill indemnification. Fairly “liberal” system.

- Neither Distributors nor Suppliers can theoretically claim indemnification if the agreement is terminated (except if a fixed-term agreement is early terminated, in which case contractual liability applies)

- However, protection offered by commercial agency law may be requested by Distributor in a limited number of cases
2. Statutory provisions and other consequences

The “Austrian” analogy system is never applied to French distribution agreements as such - however, so-called independent “Distributor” may benefit from such statutory provision if he has in fact the power to negotiate the sale of products / services on behalf of Supplier (mandate).

• Paris Court of appeal, Feb. 28, 2013, RG n°11/07982 : “The claimant had, contractually and practically no power to modify the T & C’s of mobile phone subscriptions” - claim dismissed

• Dijon Court of appeal, Dec. 6, 2011 (Jurisdata n°2011-030106): Identical legal arguments were developed to no effect by retailers distributing consumer products (mainly clothes) on their behalf for the benefit of Suppliers (commission-based affiliation contracts).
2. Statutory provisions and other consequences

- Art. L. 134-12 of the French commercial Code:
  “If their relationship with the Principal ceases, commercial agents shall be entitled to a compensatory payment for the loss suffered”

- Notwithstanding the way the law is drafted, the “actual loss” does not have to be proved, and the agent is quite systematically awarded a 2-year commission indemnity. Indemnification is mandatory whether the agreement was entered into for an unlimited duration or not.

- Main exceptions: gross negligence of the agent, termination decided by the agent, transfer of the agency agreement to a third party.
2. Statutory provisions and other consequences

Goodwill indemnity for agents – method of calculation

• 2 different systems of calculation in Europe (“German” and “French” system) based on Art 17 (2) & (3) of the EU Directive 86/653/EEC

• Indemnity system vs. compensation for damages system
2. Statutory provisions and other consequences

Differences between the “German/Austrian” and the “French” way of calculation

Indemnity claim

- depends on new costumers or increased turnovers with old costumers
- calculation method with several steps and reductions for various reasons - focus past and future
- max. one year’s commission (calculated from average of last five years)

Compensation for damage

- no prerequisites for compensation claims
- Art. L. 134-12 of the French commercial Code (see below)
- 2 year commission (based on the average of the last three years)

The agent must notify the Principal about his entitlement within one year after the termination, in order to avoid statute of limitation (Art 17 (5) EU Directive 86/653/EEC)
2. Statutory provisions and other consequences

Different Systems of Distributors’ indemnifications in other countries (Belgium, France, Portugal)

Belgium

• there is no need for analogy as the claim is directly stated in the law (specific law applicable for the termination of exclusive distribution agreements from 1961)
• applies to exclusive and quasi-exclusive distribution agreements and distribution agreements where important obligations are imposed on Distributor
• it is only applicable for Distributors under the following conditions:
  – the terminated agreement was a contract for an indefinite period;
  – it was terminated by Supplier – not for serious breach of the contract by Distributor
  – or by Distributor because of a serious breach by Supplier
• calculated on the basis of relevant circumstances
• this has led to compensation between 6 months of net profit – 24 months of gross profit recognised by jurisprudence
2. Statutory provisions and other consequences

Portugal

• analogue application of for commercial agents’ goodwill indemnity – comparable criteria to Austria
3. Systems of recognizing an indemnity or compensation to Distributors for “insufficient term of notice”

1. The French system – legal regulations – “termination without reasonable notice”

2. Austrian System – no specific law – application of general rules of contract law and compensation for damages
3. Systems of recognizing an indemnity or compensation for “insufficient term of notice”

The French system based on legal regulations – “rupture brutale”

(French law – Art 442-6-I-5° Code de Commerce,)

Applicable to all distribution agreements: whether supported by a signed contract or not, whether entered into for a fixed-term period or not. Only requires a stable and continued business relationships. Benefits to Distributors and Suppliers alike.

Exception: not applicable if a specific statutory provision applies:

- e.g. agency agreements (Aix Court of Appeal, 16 Jan. 2014, RG n°12/09468)
- e.g. bankruptcy proceedings (Lyon Court of Appeal, 15 May 2014, RG n°14/00123)

but applicable to car distribution agreements notwithstanding EU regulation

No specific remedy is set within the law. Written notice of termination required. Damage therefore assessed on usual grounds: actual losses and profits the victim has been deprived of (Art. 1149 of the French civil Code).
3. Systems of recognizing an indemnity or compensation to Distributors for “insufficient term of notice”

Art. L. 442-6 I 5°:
« Any producer, trader, manufacturer or person recorded in the trade register who commits the following offences shall be held liable and obliged to make good the damage caused (...) : abruptly breaking off an established business relationship, even partially, without prior written notice commensurate with the duration of the business relationship and consistent with the minimum notice period determined by the multi-sector agreements or in line with standard commercial practices. Where the business relationship involves the supply of products bearing the distributor's brand, the minimum notice period shall be double that which would apply if the products were not supplied under the distributor's brand (...) »
3. Systems of recognizing an indemnity or compensation to Distributors for “insufficient term of notice”

- Supplemental to « classical » tortious liability
- Massive number of cases tried every year: 183 cases tried by Courts of appeal in 2014
- Useful summary of all cases published and analysed annually by the “Commercial Practices commission” or “CEPC”: http://www.economie.gouv.fr/cepc/etudes-commission-0
- Criteria used to assess whether the agreement was terminated with “reasonable notice or not:
  - duration of the uninterrupted business relationship
  - economic dependency of the Supplier / Distributor
  - nature of the goods
3. Systems of recognizing an indemnity or compensation to Distributors for “insufficient term of notice”

- Exclusivity if any
- Reasonable time which would be necessary to establish a similar turnover with a third party Supplier / Distributor
- Good faith / bad faith
- (circumstantial evidence)

Reasonable notice goes up to 2 years, rarely more, and is intimately linked to the facts of the case:
Paris Court of Appeal, April 9, 2014 (RG n° 12/01972) : 19 year agreement, reasonable notice = 12 months
Paris Court of Appeal, April 4, 2014 (RG n° 12/00766 : 16 year agreement, reasonable notice = 24 months
3. Systems of recognizing an indemnity or compensation to Distributors for “insufficient term of notice”

Assessment of damages takes into account a wide range of criteria:

• Principle: loss of gross margin which should have been cashed in by the “victim” if it had been given reasonable notice; (sometimes loss of turnover)

• Adjustments:
  - trend of operating profits
  - undepreciated investment costs
3. Systems of recognizing an indemnity or compensation for “insufficient term of notice”

Austrian System: Based on general rules of contract law and compensation for damages

- **fixed term contract**
  - before the end of term: termination for an important reason – **no notice period**

- **contract for an indefinite period**
  - term of notice **not defined** in the contract - ordinary termination with **sufficient notice** period
  - earlier termination = breach of contract → **compensation for damages**

  - not possible at an **inopportune moment**
  - not possible with **inappropriate notice period**

  - if not respected → **compensation** for damages
3. Systems of recognizing an indemnity or compensation for “insufficient term of notice”

Austrian System: Based on general rules of contract law and compensation for damages (no specific law) II

**appropriate notice period**

- not defined by law - every single commercial relationship has to be **individually assessed** under the following criteria:
  - type of business (e.g. seasonal business), intention of the parties, duration of contractual relationship, investments, if similarity to commercial agent → as a reference the terms for commercial agents could apply
  - inappropriate notice period: compensation for lost profits for the period until the end of the sufficient term is due
3. Systems of recognizing an indemnity or compensation for “insufficient term of notice”

Austrian System: Based on general rules of contract law and compensation for damages (no specific law) III

**inopportune moment**
(e.g. shortly after an important market communication, illness of Distributor)

- inopportune moment means that a termination would have substantial disadvantages for the other party and could be avoided by choosing a different date of effectiveness of termination →
- termination is not valid until the reason for the inopportunity ended →
- non-performance of the terminating party during this period = breach of contract →
- compensation for damages for non-performance of the contract
Example:

• fashion shop in the city centre of Vienna starts to distribute the products of a – at that time “unknown” – Belgian fashion designer
• no written contract, exclusivity unclear, no termination regulation at all
• Belgian producer terminates the agreement after 20 years of business relationship by giving notice 6 months prior to intended termination

→ Shop owner wants to know if she is entitled to claim compensation

Austrian system:

• no investment compensation
• no analogy to agency agreement
• was term of notice sufficient or insufficient?

→ summer collection must be ordered 1 year prior to sales period, so:
→ 6 months = insufficient term of notice in the light of the concrete business relationship
French system:
• no specific statutory protection of the retailer -> application of “rupture brutale”
• damages may exclusively be sought under Section L. 442-6 of the French commercial Code
• termination is likely to be viewed as “brutale” after 20 years
• retailer should presumably have been offered a 18 to 24months time period to develop a new brand whose precise duration would depend 1/ on the time of the year termination notice was received (seasonal products and orders) and 2/ on the turnover trend over the past 5 years, 3/ potentially on the fixed duration of the leasing agreement entered into by retailer in relation to the premises
• conclusion: retailer likely to get 12 to 18 months of gross margin
• NB: Subjective approach, and solutions vary from one court to the other
4. Other consequences of termination

Besides monetary consequences, termination can have other non-monetary “costs” for both parties.

- Non-compete clauses
- Other consequences: unpurchased stocks, disclosure of know-how etc.
4. Other consequences of termination

Non-compete clauses

EU definition, Regulation 330/2010, Art. 5,1,b: “Any direct or indirect obligation causing the buyer, after termination of the agreement, not to manufacture, purchase, sell or resell goods or services”

EU Scope of block exemption: such clauses are exempted if:
• the obligation relates to goods or services which compete with the contract goods or services;
• the obligation is limited to the premises and land from which the buyer has operated during the contract period;
• the obligation is indispensable to protect know-how transferred by the supplier to the buyer;
• the duration of the obligation is limited to a period of one year after termination of the agreement;
• NB not applicable if agreement falls outside the scope of such regulation
4. Other consequences of termination

Non-compete clauses under French law

• A wider scope of validity so far, subject to competition law.

• According to case law, such clauses were deemed valid if:
  of a limited duration, over limited geographical areas, with a limited scope, provided that
  they were necessary to protect the “legitimate interests” of Supplier

• Article L. 341-2 of the French commercial code resulting from a law dated August 6, 2015 shall alter
  this scope of validity from August 2016 onwards. It mirrors the aforementioned EU regulation.
Thank you!

Dr. Claudio Arturo
PETSCFROSCH KLEIN ARTURO
Rechtsanwälte
Esslinggasse 5, 1010 Vienna, AUSTRIA
T +43 1 586 2180, F +43 1 586 2235
claudio.arturo@pfka.eu

Maître David Pinet
LEBRAY & ASSOCIES
Avocats
7, rue de Madrid, 75008 Paris, FRANCE
T +33 1 44 90 17 10, F +33 1 44 90 17 30
d.pinet@lebray.fr