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GOODWILL INDEMNITY IN GERMANY

Introduction

In Germany, there have been several court decisions which granted indemnity to franchisees after the termination of the agreement. For the greater part, German legal literature also takes the view that franchisees are entitled to claim indemnity. However, as opposed to other countries, indemnity is not granted for goodwill in the strict sense of the word. It rather constitutes a compensation for the loss of those advantages upon the termination of the agreement, which the franchisee has been able to derive from the use of the clientele during the term of the agreement. Thus in German law, in German court decisions and in German literature the term 'compensation claim by the franchisee' is used rather than 'goodwill indemnity'. However, for the sake of this presentation and in order to provide a certain degree of comparability, the term 'indemnity' will now be used, but not the term goodwill indemnity, as the indemnity is not for a compensation of goodwill.

Indemnity claims raised by franchisees after the termination of a franchise agreement are legally based on art. 89 b of the German Commercial Code. In German law, the question has been raised whether the provisions of art. 89 b of the German Commercial Code can be applied by analogy to franchisees in general, or at least to certain kinds of franchisees. In Germany, however, these are the only debatable aspects in connection with indemnity claims by franchisees, as ownership issues concerning intellectual property rights are regarded as irrelevant in the assessment of this question. In this presentation I will therefore first focus on outlining the provisions of art. 89 b of the German Commercial Code (I) before turning to the development of German law concerning the analogous application to other commercial agents (II).

Finally, the question as to how and in what way the provisions of art. 89 b of the German Commercial Code can be applied to franchisees, in particular master franchisees, will be discussed (III).

I The Provisions of art. 89 b of the German Commercial Code

The provisions of art. 89 b of the German Commercial Code were introduced into German law in the 1950s. For the purpose of this presentation it may be useful to first analyse the circumstances which led to the law's introduction (1) before presenting an English translation of the law's wording (2). On this basis the legal requirements for granting indemnity can be summarised (3). However, the law does not provide any guidelines for the calculation of indemnity claims (4). Cases which do not incur indemnity claims can be identified easily from the wording of the article (5). Finally, the mandatory character of the provision will be pointed out (6).

1. Circumstances which led to the introduction of art. 89 b of the German Commercial Code

The introduction of art. 89 b of the German Commercial Code into German law was closely connected to the legal regulation of commissions for agents. According to art. 87 subparagraph 1 of the German Commercial Code, commercial agents are entitled to commissions for all business transactions that they have effected, if there is a causality between the activity of the agent and the particular business transaction. The causal link may even be quite week, the activity of the agent may just be one of the causes for the conclusion of the business transaction. If a customer, who was originally acquired by the sales agent, later does business with the principal without being supported by the commercial agent, the commercial agent has nevertheless contributed to the conclusion of these business transactions. As a result, according to German law, commercial agents have to be remunerated for their agency activities over a very long period of time. When negotiating commission fees, this legal situation is usually taken into account.

To sum up, if a customer, who was originally acquired by the commercial agent, keeps on doing business with the principal during the term of the agency agreement, the commercial agent will always be entitled to receive a commission for acquiring this customer. German legal opinion takes the view

that such commissions are justified because principals continue to benefit from customers that were originally acquired by commercial agents.

According to German law all commission claims end upon the termination of the agency agreement. If, however, customers keep on doing business with the principal after the termination of the agreement, the principal continues to benefit, whereas the commercial agent is no longer able to reap the fruits of his labour. In Germany, this was considered unfair and inequitable. As a consequence, the provisions of art. 89 b of the German Commercial Code were created as a remedy. Thus, the introduction of the provisions of art. 89 b of the German Commercial Code was strongly based on ideas of equity and the notion of equity has an important role in the wording of the article.

2. The wording of the law

The wording of art. 89 b of the German Commercial Code is as follows (this translation of the text is taken from the IDI website and reproduced here after some corrections).

(1) After termination of the contractual relationship the commercial agent may demand from the principal reasonable compensation if and insofar as:

1. The Principal derives also after contract termination substantial benefits from the business with new customers brought by the agent and
2. the payment of a compensation is equitable having regard to all circumstances of the case and, in particular, the commission lost by the agent on the business transacted with such customers.

A customer can be said to have been recruited if the commercial agent has so significantly increased business relations with a customer that this corresponds in commercial terms to the recruitment of a new customer.

(2) Such compensation shall amount to not more than one year's commission or other annual remuneration calculated on the basis of the average of the last five years' activities of the commercial agent; where the contractual relationship has been of shorter duration, the average during the period of activity is to be taken as the basis.

(3) Such claim shall not arise, if

1. the commercial agent has terminated the contractual relationship, unless the conduct of the principal has given good cause for such termination, or, by reason of age or illness, the commercial agent could not reasonably be expected to continue his activity, or

2. the principal has terminated to contractual relationship for good cause justifying immediate termination by reason of fault on the part of the commercial agent, or
3. by agreement between the principal and the commercial agent a third party assumes the contractual rights and liabilities of the commercial agent in his stead; such agreement may not be concluded before termination of the contractual relationship.

(4) This claim may not be excluded in advance. It must be asserted within one year of termination of the contractual relationship.

(5) .... Special rules on insurance agents ....

3. Requirements for granting termination indemnity in compliance with art. 89 b of the German Commercial Code

According to the law's wording, termination indemnity can only be granted, if the customer was brought by the commercial agent and if the principal continues to derive advantages from the business with such a customer, whereas due to the termination of the agency agreement, the commercial agent is no longer entitled to receive any commissions. Finally, certain aspects of equity have to be taken into account.

4. Calculation of indemnity

In Germany, calculation of indemnity is an extremely difficult matter. The calculation of compensation claims has not been fixed by law. However, an upper limit was laid down in art. 89 b subparagraph 2 of the German Commercial Code. As a rule, calculation of indemnity is based on a hypothetical analysis of the situation. Allowing for an adequate churn rate, the calculation of termination indemnity is based on the commissions which the commercial agent is potentially able to generate from his clientele as of the termination of the agency agreement over a forecast period of four or five years. The amount is then discounted to present-day value. In this context, it may be important to point out that the level of indemnity is only influenced by commissions which are considered a form of remuneration for agency or acquisition activities.

According to the upper limit set forth in art. 89 b, paragraph 2 of the German Commercial Code indemnity must not exceed the amount of an annual commission. This upper limit comprises all components of a commission, including remunerations which the commercial agent has received for

services other than agency or acquisition activities, such as remunerations for storing goods.

5. Cases which do not incur indemnity

In case the principal terminates the agency agreement for cause, or if the commercial agent terminates the agency agreement without cause, the commercial agent is not entitled to claim indemnity. In addition, indemnity may not be incurred if the commercial agent has assigned his rights and obligations under an agency agreement to a legal successor who agrees to make a payment which is approximately equivalent to a potential indemnity payment.

6. Mandatory character of the provisions of art. 89 b of the German Commercial Code

According to art. 89 b of the German Commercial Code, claims for indemnity cannot be waived prior to the termination of the agency agreement. This provision has influenced the legislative bodies of the European Union. Following German law, a European directive was passed which expects Member States to offer protection to commercial agents. The European provisions have an international mandatory character. The Court of Justice of the European Union ruled that choice of law clauses which put commercial agents based in the European Union at a disadvantage by forcing them to opt for a law outside the European Union are invalid, as such a choice of law clause would bypass the mandatory character of the provisions. In 2006 the Court of Appeal of Munich went a step further. In this case, both a place of jurisdiction and a law outside the European Union had been agreed upon. The Court of Appeal deemed it possible that a court outside the European Union might not observe the mandatory character of art. 89 b of the German Commercial Code. In the opinion of the court, the combination of the choice of law clause with the choice of jurisdiction clause was aimed at bypassing the international mandatory character of art. 89 b of the German Commercial Code. On these grounds, the choice of law clause and the choice of jurisdiction clause were declared null and void. As a consequence, the commercial agent was allowed to file a suit in Germany. In 2011 the Court of Appeal of Stuttgart had to decide a similar case and decided in the same way. He even declared that this matter was so undisputed in Germany that there is no reason for appealing to the German Supreme Court or the Court of Justice of the European Union.

II Developments in the analogous application of art. 89 b of the German Commercial Code to other distribution intermediaries

Some years after art. 89 b of the German Commercial Code had come into force, the question was raised whether it was possible to apply by analogy the basic principle of art. 89 b of the German Commercial Code to other distribution intermediaries. On 3 May, 1983, the Bundesgerichtshof, the Supreme Court in civil matters in Germany, ruled that it was permissible to apply the provisions of art. 89 b of the German Commercial Code by analogy to authorised dealers. However, the Supreme Court made it clear that an application by analogy was only permissible if certain conditions were met. In particular the principles developed by the Supreme Court can also be applied to various other types of distribution intermediaries. I will therefore present these principles in more detail.

According to the Court's decision, the first requirement for an analogous application is that the distribution intermediary is part of the sales organisation just like a sales agent. There must be a legal relationship between the company and the authorised dealer which goes beyond a mere sales contract. It is considered essential that the authorised dealer has taken on tasks which resemble the duties of a sales agent.

The second requirement for an analogous application is that upon termination of the agreement the distribution intermediary has to surrender his clientele to the principal, who will then be able to derive advantages from the use of this clientele. If the distribution intermediary is allowed to use the clientele for his activities even after the termination of the agreement, it is not possible to apply art. 89 b of the German Commercial Code by analogy. In its decision of 1983, the Court issued much stricter requirements concerning the transfer of the clientele to the principal. Over the years, however, there has been some relaxation.

III Analogous application of art. 89 b of the German Commercial Code to franchisees and master franchisees

Whenever German courts or German legal literature had to deal with indemnity issues, the question was raised whether it was possible to apply the provisions of art. 89 b of the German Commercial Code by analogy. German jurisprudence hardly ever discussed any other legal basis for an indemnity for franchisees.

The debate on the requirements for an analogous application follows to a large extent the line of reasoning used in the discussion on the requirements for an analogous application to authorised dealers. German courts did not yet have the opportunity to deal with any indemnity claims by master franchisees and in German legal writing this issue is not discussed yet.

As a rule, it will be easier for franchisees than for authorised dealers to meet the requirement that the agent has to be part of the principal's (or in the case of franchising: franchisor's) sales organisation. Franchise agreements typically contain provisions that obligate the franchisee to maintain a uniform image and to comply with the operational standards detailed in the franchise operations manual. These provisions indicate that franchisees are more integrated in the sales organisation than authorised dealers.

It must be pointed out, however, that in some cases the situation as regards master franchisees may be different. If the franchisor has given the master franchisee completely free rein to develop the franchise system in his country or territory, the franchisee may perhaps not be regarded as being integrated in the franchisor's sales organisation. In this case the requirements for the analogous application of the law are not met.

More difficulties arise from the requirement that the clientele has to be transferred to the franchisor or general franchisor upon termination of the agreement. In the past, this requirement was interpreted quite a strict manner. There had to be a contractual obligation of the franchisee to hand over the actual customer files. In recent years, however, there has been some relaxation. It is now sufficient that, due to factual circumstances, the majority of customers pass over to the franchisor or to a franchisee or another distribution intermediary appointed by the franchisor, as is often the case with businesses based on cash transactions, particularly when the franchisor has secured the premises of the franchise business for himself. Strong brand loyalty also suggests that the clientele has in effect been transferred.

In most cases, German courts ruled that the requirements for an analogous application of art. 89 b of the German Commercial Code to franchisees were met. However, in some cases the courts deemed the requirements not met. In each of these cases the courts rejected claims for indemnity on the grounds that the clientele had not been transferred.

The calculation of indemnity levels for franchisees is still largely unclear. The calculation method mentioned in section I 4 is based on the commissions of commercial agents, which, however, form only a small part of the revenues generated by the sale of goods or services. Franchisees and authorised dealers, on the other hand, generate their revenues directly from the sale of goods and services to customers. Their earnings consist of the complete consideration for goods and services. In this context, jurisdiction raised the question whether these circumstances have to be taken into account when calculating indemnities. In one case, the court ruled that not more than ten percent of the franchisee's earnings were equivalent to the income of a sales agent. As a consequence, the calculation of the indemnity as explained in section I 4 was made on the basis of only 10 percent of the turnover of the franchisee. In another case, the court ruled that ninety percent was equivalent to the income of a sales agent. However, in most court decisions, the calculation of indemnity ranges somewhere in between. Thus, we may record that German jurisdiction does not have consistent guidelines for calculating indemnity levels.

In my opinion, a possible approach for a solution of this problem that even with agents a distinction is made concerning components of their commission related to acquisition activities. The hypothetical calculation may only be based on those elements of the commission, which tend to compensate the acquisition activities, whereas the upper limited is based on the entire commission received.

It could be considered to base the calculation of indemnity levels for franchisees as well only on their remuneration for acquisition activities in the framework of the hypothetical calculation, while the upper limit takes their complete undiminished turnover into account.