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The effectiveness of minimum turnover clauses in agency agreements: termination and indemnities

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Summary

1. Introduction

Agency agreements sometimes contain a minimum turnover clause whereby the agent is obliged to reach a minimum target. Failure to attain this contractual obligation can lead to contract termination without compensation. However, the objective fact of non-attainment does not necessarily amount to a breach of contract which could justify such early termination.

The aim of this short Article is to highlight the circumstances under which the agency agreement can be terminated and to which extent the non-attainment of turnover will justify an immediate termination without indemnity.

The EC-Directive 653/86 from 18 December 1986 (EC Directive on Commercial Agents, hereinafter referred to as "the Directive"), was implemented into Belgian Law by an Act of 13 April 1995, which came into force on 12 June 1995. This Act has been modified by the Act dated 4 May 1999 and by the Act dated 21 February 2005, which became effective on 26 March 2006. The provisions of the Act of 1995 have then been implemented in the new Code of Economic Law by law of 2 April 2014 (now to be found in Book X, Title I of this Code : Commercial Agency Contracts).

2. How to terminate the contract ?

Under Book X, Title I of the Code of Economic Law regarding the commercial agency contracts, there are two ways to terminate the contract.

2.1. With a notice period

According to Article X.16 of the Code of Economic Law :

> *"When the commercial agency contract is concluded for an indefinite period or for a fixed term with a possibility of prior termination, either party may terminate it with a notice period."*

One month's notice is to be given during the first year. After the first year, the notice period is increased by one month for every year, with a maximum notice period of six months.

2.2. With immediate effect

Title 1 of Book X of the Code of Economic Law foresees in Article X.17 that :

> *"Either party may, subject to any damages, terminate the contract without notice or prior to the expiration of the term, where* ***exceptional circumstances*** *render it permanently impossible to continue any professional collaboration between the principal and the agent or due to a* ***substantial breach*** *by the other party of its obligations."*

The legislator confers a ***mandatory character*** to this provision as it is specified in the last paragraph:

> *"Notwithstanding any conflicting stipulations, it cannot be derogated before the end of the contract, to the detriment of the agent, to this Article".*

It follows that an agreement for a fixed period of time can be terminated earlier and an agreement for an indefinite period of time can be terminated without previous notice in two different cases:

* when a party fails seriously to fulfil his or her obligations (**substantial breach**) which may be contractual or extra-contractual,

* when the occurrence of **exceptional circumstances** renders all professional cooperation between the parties definitively impossible (age and health of the agent, *force majeure*, hardship, *intuitu personae*).

We will not deal with exceptional circumstances in this overview.

Early termination for serious breach is an **exceptional manner of contract termination** foreseen in Article X.17 of the Code of Economic Law. Termination for serious breach aims at **sanctioning** the other party by denying:

- the other party the benefit of a notice period and
- the agent the benefit of a goodwill indemnity and of possible additional damages.

3. What are the requirements of termination for breach?

3.1. The breach must be serious

Though the substantial breach is not defined as such under the Belgian law, according to the preparatory work for the Agency Act and according to case-law, it refers to a breach making it **permanently impossible** to continue any professional collaboration between the principal and the agent and which is at the discretion of the judge.

Some examples from case-law of a **serious breach** attributable to the **Agent**:

* Failure to pay bills and the issue of bad checks by an agent who had the power to make direct purchases from the Principal were considered a serious breach,
* The bank agent who appropriated the sum of €2,231 belonging to the bank to temporarily deal with a private cash matter, although he was able to return the funds and that he actually did return them at the end of the month following the withdrawal,
* Accepting bribes,
* Representing other companies although the contract prohibits the agent to do so,

* The refusal from the agent to inform the principal about market conditions,
* The excessive use of alcohol during working hours, directly related to a decrease in business,
* The fact that the agent employs the principal's money for his own private use,
* The agent counterfeiting the principal's products,

Some examples with respect to **serious breach** attributable to the **Principal**:

* The designation of a second agent whilst the agency agreement ensured exclusivity,
* Non-payment of commissions.

On the other hand, here are some examples where the court **did not admit serious breach**:

* The turnover decreases in the agent's sector, whilst the turnover increased in other sectors,
* The transmission of only few orders or the lack of achievement of sales targets set up in the contract (Antwerp, 13.0.2003; Kh. Brugge, 26.03.2002),
* The insufficient results of an agent will not be considered as a serious breach per se, but it may be so if elements establish that he/she has made characterised errors, which are the main reason of this insufficiency (Brussels, 03.12.2004).
* When the contracting parties have determined what they consider a serious breach, this does not limit the discretion of the judge, however can be considered as an indication to the judge as to what the parties regarded as an essential obligation. The non attainment of the contractually established minimum turnover quota, in principle will not be considered to be a serious breach, if there is not at the same time a manifest and persistent failure by the commercial agent, not making any or insufficient efforts to promote the interests of the principal (Brussels, 06.09.2011).

It follows that the **non-attainment of the minimum turnover** by the agent does ***not in itself*** constitute a serious breach of contract and that it does not automatically exclude the agent's right to a goodwill indemnity.

Some elements outside of the agent's control could actually explain his low turnover: force majeure, economic circumstances, change in fashion, low quality or high-priced products, lack of notoriety of such products, poor collaboration by the business manager to reach common objectives.

If deduced only from the turnover, the presumption of insufficient activity is therefore very relative.

3.2. Notification and start point : formalities to be complied with - Sanctions

Formalities

Termination must be notified to the other party within **7 working days** of the acknowledgment of the occurrence of the facts which entitle this termination.

Literature has adopted a flexible interpretation of the start point: the period depends on the moment when the party terminating the contract acquires full knowledge of all the circumstances of the breach that can justify this early termination.

There are no formal requirements upon terminating an agency agreement for serious breach. Each of the parties may notify the other of its decision to terminate the contract both verbally or in writing. For obvious reasons, termination will most often be notified in writing.

Moreover, the **grounds that justify** the termination need to be communicated to the other party by registered letter or writ (i.e. through a bailiff) within **7 working days** of the termination of the contract itself, which means it has to be added to the initial seven day period. The Court of Cassation (9 January 2006) settled that the communication by registered letter or writ is not required under penalty of nullity, but that it could be replaced by an equivalent act, provided that it is certain the addressee has received the communication within 7 working days after termination. It is however clear that this might be very difficult to prove and is thus to be avoided.

In practice the termination and the grounds will be notified at the same time by registered letter.

Short notice period ?

According to case-law, granting a notice period, even if short, is to be excluded and would be ***inconsistent*** with the termination for serious breach since it is required to fulfil the condition of urgency. (ex. Comm. Brussels, 30 June 2008, RW 2009/10, n°24, p.1011).

The breach must, as a matter of fact, be of such magnitude that the contractual relationship could no longer be continued, even temporarily until expiration of a notice period. The obligation to terminate the contract within a very short period of time after learning the grounds which justify such termination (merely 7 days) confirms this element. It thus presumes that the party who has not terminated the contract within this short period cannot any longer avail himself of a serious ground. The law thus seeks to prevent the threat of an extended rupture, which could lead to a precarious situation.

Sanction

Failure to meet the formal requirements will have serious repercussions for the Principal : it will deny him the right avail himself of the serious breach. This entails that the agent will be entitled to claim damages, including for goodwill and for the absence of notice period.

3.3. Discretion of the judge

Since Article X.17 of the Code of Economic law is a mandatory provision, the severity of the grounds is ***always*** left to the discretion of the Court, even if the parties have explicitly mentioned which grounds would be considered a serious breach (see above).

4. Express termination clause (*uitdrukkelijk ontbindend beding / clause résolutoire expresse*) : possible escape from Article X.17 of the Code of Economic Law ?

4.1. In general

Apart from the two possibilities foreseen in the Code of Economic Law with respect to agency agreements that we have briefly dealt with above (*notice period or immediate termination for breach*), Article1184 of the Belgian Civil code provides the possibility for each party to a synallagmatic contract to request the court to pronounce the termination of the contract (*ontbinding / résolution*) for a (serious) breach committed by the other party.

This Article states the following :

> *"A termination clause is always implied in synallagmatic contracts in the event of one of the two parties failing to perform its contractual obligations.*
> *In that situation, the contract is not terminated as of right. The party to which the obligation is owed can choose whether to compel the other party to perform the agreement where that is possible or to request termination of the agreement with damages and interest.*
> *Termination must be requested by court application, and the defendant may be granted a period in which to comply depending on the circumstances."*

By providing for an express termination clause, the parties can however mutually agree to place themselves outside the scope of Article 1184 and ***set out the circumstances*** in which a breach is sufficiently serious to warrant termination of the agreement as of right without a court's intervention and without a prior formal notice.

Within the *classical approach*, whenever the contract's termination is disputed, the Belgian courts may only verify whether the conditions of the clause were met (the reality of the breaches mentioned in the contract) and not whether they were indeed serious enough (gravity of the fault).

Within the *modern approach*, however, the court has the power to proceed with a double verification, by which it ensures:

* The regularity of the clause
* The legitimacy of the clause (albeit marginal)

Through the regularity control, the court checks the formal legality of the termination, i.e. whether the clause was admissible and whether the invoking thereof was in line with the agreed conditions for the application of the clause.

Through the legitimacy control, the court checks whether the unilateral decision to terminate the contract is in line with the requisites of good faith and ensuring that there is no abuse of rights. It follows that the court may thus control the magnitude of the fault, albeit through a marginal review, taking all circumstances into account.

The Belgian Court of Cassation has ruled that the unilateral termination of a contract which is based on an express termination clause by a party may constitute an abuse of rights.

Therefore, the courts may *a posteriori* control the reasonableness of the decision (marginal control). For instance the court may check whether the damage caused is proportional to the advantage sought by the holder of the rights (Cass. 09.03.2009; Cass. 08.02.2010; Cass. 05.12.2014).

The Belgian courts thus have a ***discretionary power to determine post factum*** whether the breach was sufficiently justified. If they decide that it was not the case, the termination may be considered wrongful. If the courts find the termination wrongful, they may grant damages to the other party or may order the forced performance of the agreement. It should be mentioned that in a rather recent case, the Belgian Court of Cassation, found that all the contractual conditions to declare termination of the contract were not fulfilled and decided therefore that the contract could not be terminated and had to stay in force (Cass. 11 May 2012).

4.2. In agency agreements

It has to be pointed out that Belgian literature and case law are not unanimous concerning validity of the express termination clauses provided **in an agency agreement**.

The **first question** to be resolved is whether the insertion of such a clause is formally legal (independent of a possible *a posteriori* control by a court), since Article X.17 of the Code of Economic Law provides very strict conditions (also formal ones) to be met for a termination with immediate effect. As we have seen, this article is mandatory.

Some are of the opinion that an express termination clause in an agency contract is null and void, because it would constitute a restriction to the judiciary review and to the mandatory nature of Article X.17. of the Code of Economic Law.

Others are of the opinion that such a clause is perfectly valid since the Agency Act does not prevent the parties from terminating their contract according to the common rules on obligations as set forth in the civil code.

According to a *third opinion* the express termination clause in a commercial agency contract would not be invalid as such, but the court will not be bound by the clause since Article X.17 of the Code of Economic Law is a mandatory provision. The importance of the clause will then merely remain to make it clear to the court which obligations were considered as essential. The judge may take this into account but is certainly not bound by what the parties have determined beforehand to be serious breaches. Moreover, it seems obvious that the (formal) conditions for application of the clause and the execution thereof have to be in line with the requisites of Article X.17 of the Code of Economic Law.

This brings us to the **second question** concerning the *a posteriori* verification by the court.

Since Article X.17 of the Code of Economic Law is mandatory, it seems obvious that the court will have the power to verify the seriousness of the breach. As a matter of fact, the express termination clause may not be used by the parties to evade the mandatory requirements of the law.

The judicial review cannot be limited to the discovery of the alleged breach. It is essential that verification of a serious breach is left to the judge and not only to the parties.

Any interpretation to the contrary would lead to render inoperative Article X.17 of the Code of Economic Law, for example by stating that in case of breach, however minor it may be, the Principal can immediately terminate the contract without being held to provide any compensation. The legislator has submitted the act of calling upon a serious breach to very strict conditions and deadlines. This Article is a mandatory provision. Moreover, to enable a real and effective *a posteriori* control by the court, the formal requirements of Article X.17 of the Code of Economic Law also have to be complied with in the case of a termination clause.

The usefulness of an express termination clause resides thus in providing a scale of values that may inspire the judge during his material appreciation of the breach invoked according to the express termination clause (Rb. Kh. Dendermonde, 24.10.2008).

5. What are the consequences of the termination of the contract ?

5.1. If the judge considers there is indeed a substantial breach

The Agent is denied:

- An indemnity in lieu of notice,
- A goodwill indemnity,
- Any possible additional indemnity.

The Principal will be entitled to damages provided that he proves his damages and the causal relationship between the breach (fault) and the damages suffered.

5.2. If the judge doesn't consider it to be a substantial breach

In that case the termination will have been carried out without granting a notice period. The agent may then claim :

- An indemnity in lieu of notice,
- A goodwill indemnity,
- Any possible additional indemnity.

5.3. How to calculate the indemnities?

(i) As far as the **indemnity in lieu of** is concerned, we have seen above that notice periods from 1 to 6 months are normally due (Article X.16 of the Code of Economic Law). The indemnity in lieu of the period which has not been granted is calculated as follows :

> "*Where the remuneration of the commercial agent consists wholly or in part by commissions, the current remuneration is calculated based on the average monthly commissions earned during the twelve months preceding the date of termination of the agency contract or, where required, the months preceding the date of termination of the commercial agency agreement*"

(ii) As far as the **goodwill indemnity** is concerned, it is clear that all conditions thereto have to be met. Under Article X.18 of the Code of Economic Law, the agent is, after termination of his agency agreement, entitled to a goodwill indemnity if and to the extent that :

* *He has introduced new customers to the principal or has significantly increased the volume of business with existing customers;*
* *The principal continues to derive substantial benefits from such customers after termination of the contract.*

The goodwill indemnity is calculated as follows :

> "*The amount of the goodwill indemnity is fixed taking into account both the importance of business development and the introduction of new clients. The goodwill indemnity may not exceed the amount of one year's remuneration as calculated from the average of the past five years or if the duration of the commercial agency contract is less than five years, according to the average of these previous years"*

It seems clear that a decrease in sales will surely have an impact on the *quantum* of the indemnity that a court may determine and which will be calculated inevitably on the basis of reduced commissions earned during the last 5 years of the relationship (and in any case with a maximum of one year of commissions).

(iii) As far as the **additional indemnity** is concerned, Article X.19 of the Code of Economic Law provides (in a rather odd way) that :

> "*When the commercial agent is entitled to a goodwill indemnity and when the amount of this indemnity does not completely cover the damage suffered, the agent may, provided that he proves the amount of the actual damage suffered, receive on top of this indemnity damages for the difference between the amount of the actual damage suffered and the amount of that indemnity.*"

Three interpretations have been followed so far in literature and in case law.

According to the first opinion, the additional indemnity only covers damages suffered by the agent due to the termination of the contract, except for damages for clientele.

According to the second opinion, the additional indemnity covers all damages suffered by the agent due to the termination of the contract, i.e. the damage suffered as a consequence of the loss of clientele and all other damages.

According to the third opinion, the additional indemnity only covers damages suffered by the agent as a consequence of the loss of clientele, in as far as these damages are higher than the legal cap of one year's commissions (implicitly followed by the Court of Cassation, 05.11.2009).

The problem resides in the wording of Article X.19 of the Code of Economic Law that states that the additional indemnity may be due *when the commercial agent is entitled to a goodwill indemnity*. This condition seems very strange and not in line with the Directive.

The European Court of Justice (4th Chamber) has now ruled on 03.12.2015 (Case C 338/14) upon a request for a preliminary ruling from the Brussels Court of Appeal that :

1. *Article 17(2) of Council Directive 86/653/EEC of 18 December 1986 on the coordination of the laws of the Member States relating to self-employed commercial agents must be interpreted as not precluding national legislation providing that a commercial agent is entitled, on termination of the agency contract, both to an indemnity for customers limited to a maximum of one year's remuneration and, if that indemnity does not cover all of the loss actually incurred, to the award of additional damages, provided that such legislation does not result in the agent being compensated twice for the loss of commission following termination of the contract.*
2. *Article 17(2)(c) of Directive 86/653/EEC must be interpreted as meaning that it does not make the award of damages conditional upon the demonstration of the existence of a fault attributable to the principal which caused the alleged harm, but does require the alleged harm to be distinct from that compensated for by the indemnity concerning clients.*

It follows that the first opinion mentioned above will thus have to be followed from now on. The damages that might therefore be compensated, according to Article X.19 of the Code of Economic law have to be limited to for example :

- investments and others costs incurred by the agent that have now become useless and that have not yet been set off,
- indemnities/damages that the agent has to pay to third parties because of the termination of his relationship with them due to the termination of his own relationship with his principal (sub-agents, employees, ...).

* * *