



International Distribution Institute

# **Negotiating the termination of agency, distribution and franchise agreements.**

Contractual provisions to facilitate a  
smooth transition

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Parties can already include in agency/distribution/franchise agreements terms which can resolve a number of issues that typically arise at the end of the contract :

- right of the principal/supplier to replace the termination period with a fixed indemnity,
- removing exclusivity during the termination period,
- restitution of stock of products or spare parts, etc.

## Interest in doing so:

- provides for a smooth transition,
- anticipates and resolves possible conflicts in advance,
- avoids litigation,
- limits, facilitates or guides the interpretation of contractual obligations.

- Problems that can arise:
  - in certain countries, the national law contains mandatory public policy rules that prohibit or restrict the possibility of using such "smooth transition" contractual applications.
- France is a typical example of where such rules exist.
- An additional problem is that EU law in this field tends to copy French law.
  - In particular, the EU draft on Unfair Commercial Practices.

## **Two main issues:**

**I. The notice period**

**II. The consequences of termination**



Regarding the notice period, a smooth transition means the possibility to:

- anticipate the applicable length of the notice period,
- adapt the rights and obligations of the parties relative to the notice period or during it.

# I. Organization of the notice period

## A. The length of the notice period

- This is a recurring problem. Several laws provide for an obligation to provide a reasonable notice period when terminating a contract concluded for an indefinite period.

- But case law can be very vague.

Under French case law, for example, for a commercial relationship of 13 years :

- The Versailles court ruled that 10 months were sufficient;
- The Montpellier court: one year;
- The Paris court: 2 years.

- Which is why it is always a good idea to stipulate the duration in the agreement.



- **Example:**

*"Either party may terminate the contract by complying with a notice period, the duration of which shall be:*

- *1 month where the commercial relationship is of less than 18 months' duration;*
- *3 months if between 18 and 30 months;*
- *10%, rounded up to the nearest unit, of the total length of the relationship expressed in months if the relationship is between 30 months and 13 years;*
- *7%, rounded up to the nearest unit, of the total duration of the relationship expressed in months if longer than 13 years, not exceeding a duration of 24 months maximum."*

## Possible problems in the application of such clauses:

- under French law, it is mandatory to respect a period of notice in accordance with the total length of the commercial relationship (in general, one month per year of trade with notice periods up to 24 or 36 months in practice),
- the contractual notice period must comply with the legal notice period laid down in Article L. 442-6 of the Commercial Code.

## **B. The replacement of the notice period by an indemnity**

- It is possible to stipulate the possibility for one of the parties to terminate the contract without notice (in whole or in part), by providing in the contract for an indemnity, the amount of which is fixed in advance.

- But, once again public policy provisions must be respected:
  - For example under French law it is not possible to waive compliance with a public policy provision; thus if the indemnity is lower than the statutory indemnity due, the French courts will traditionally rule it to be insufficient;
  - On the other hand, the French courts now recognize that *"although [Article L. 442-6, I, 5° of the Commercial Code] institutes a mandatory public policy obligation which parties may not waive in advance, they are not prohibited [...] from settling the sum of the indemnity for the harm suffered due to the sudden nature of that termination"* (Court of Cassation, judgment of 16 December 2014).



## Gradual decrease of business

*The 16 December 2014 ruling also states that the parties are free to "agree on the terms of the termination of their commercial relationship ... as a result of the sudden nature of that termination" .*

Although the requirement of sufficient notice is a public policy provision, there is nothing to prevent the parties from putting their business arrangements on a contractual footing for that period.

It is therefore possible to conclude an agreement providing for a gradual reduction of the volume of orders during the notice period.



## Example:

"X and Y have agreed to terminate supply contract No XXX effective as of 19 June 2017, on which date both parties will be released from all obligations under the contract. X acknowledges having been informed by Y that the business relationship between the parties will cease as of 19 June 2017 and X agrees that this information has been provided with sufficient advance notice.

The purpose of this agreement is to settle how the relationship is to be pursued between X and Y during the period from 19 June 2015 to 19 June 2017.

X agrees to purchase supplies from Y at the values stipulated in the supply contract or at least up to a stated amount and for the periods stated below :

<b>Période</b>	<b>Montant convenu</b>
19/06/2015 - 19/06/2016	xx million €
19/06/2016 - 19/06/2017	xx million €

- **Example (continued):**

X declares having enjoyed all his rights in respect of the termination of Supply Contract No XXX. Accordingly, X irrevocably waives any claim, right or action, of any nature whatsoever or any grounds resulting from the termination of the supply contact and, more generally, the termination of the commercial relationship with Y".

## **C. The exclusion of exclusivity during the notice period**

- Very common clause in practice
- Can be problematic in case of national laws imposing an absolute full notice period.

- Under French case law, stringent rules:
  - old case law: the removal of the exclusivity during the notice does not in itself constitute a sudden partial termination of the established commercial relationship,
  - new case law: *"except in specific circumstances, the grant of a notice period pre-supposes the continuation of the commercial relationship under the previously agreed terms"*, Court of Cassation, commercial chamber, 10 Feb. 2015, Seco Tools: the premature termination of territorial exclusivity with immediate effect renders the notice period devoid of interest.<sup>17</sup>



## **II. The consequences of the termination of the contract**

### **A. Post contractual obligations**



## Stock restitution clauses

Stock restitution clauses are essential in distribution, supply and franchise agreements. They are designed to avoid certain issues when the contractual relationship terminates:

- Often, at the time of the termination of the contract all the acquired products have not been sold, especially if the contract requires the dealer to hold minimum quantities of goods, or "safety reserves".
- This situation becomes detrimental to resellers if they are bound by a non-compete clause, or if a new dealers are designated by the supplier replacing them.

It is therefore of utmost importance to agree in advance on the whether the supplier will take back stock or not, to determine the method for setting the prices of returned stock, and to fix deadlines etc.

There are several types of clauses dealing with the fate of stocks in different ways:

- Clauses allowing for the sale of all remaining stocks to customer (**stock liquidation**) within a certain period
- Clauses providing for the **optional buyback** of stock by the supplier subject to certain conditions;
- Clauses providing for the **mandatory buyback** of unsold stock by the supplier;
- Clauses **excluding** the buyback of stock

- **Example:**

Clause providing for the optional buyback of stock by the supplier subject to certain conditions:

"If the present agreement is terminated before its term by the grantor or is not renewed at its expiry, the grantor reserves the right to repurchase without this right constituting an obligation on his part ... the goods that he deems to be a normal goods for sale and in perfect condition, figuring in his catalogue on the repurchase date ... " .



## Example:

Clause providing for the **mandatory buyback** of stock by the supplier:

"From the termination of the contract, and in all cases at the latest 14 days after the termination of the contract, the Distributor:

*(a) Shall return to the Supplier or the third party designated by him all the contract products, at the Distributor's expense (including the costs for the determination of the repurchase price) and risk, on condition that the contract products:*

- *were purchased directly from the Supplier and delivered by the latter,*
- *are new, unused, not damaged and intact and*
- *have not been sold, and remain the unencumbered property of the Distributor or the Supplier and are in the Distributor's possession.*

*The repurchase price of the contract goods is equivalent to the distributor's net purchase price in force, after deduction of an appropriate amount for the condition and age of the contract goods. The distributor will have to demonstrate the proof of purchase and of the price paid".*



## Example:

Clause **excluding** the buyback of stock: not always allowed under national law.

May be regarded as an unfair term.

Note: In this case, it is in the interests of suppliers to ensure they have either included a sufficient notice period or that they allow former distributors use their distinctive signs subsequent to the termination of the contract, to facilitate the quick sale of remaining stock and under normal conditions (excluding for discount and closing down sales).

## **Clauses of cessation if use of distinctive signs subject to penalties**

The provision to the franchisee of distinctive signs of the franchisor is an essential element of a franchise agreement, the termination of the latter requires the franchisee to return all signs, advertising material and the documents provided by the franchisor, usually subject to a penalty provided for in the contract.

As a general rule, franchisees must remove all references to the different elements relating to the franchise (acronyms, symbols, logos etc.).

Franchisees failing to comply with this obligation may be held liable under the trade mark infringement or unfair competition laws.

## Example:

*"At the end of the present agreement, in all cases of termination, the Dealer shall immediately cease all use, whether direct or indirect, of the trade mark and eliminate any distinctive sign of the mark contained notably on its premises, commercial documents or on websites.*

*After a period of 15 (fifteen) days after the date of effect of the termination, this obligation will be accompanied by a penalty of 500 (five hundred) euros per day, multiplied by the number of places where those violations are committed",*

## **Non-compete or non-(re)affiliation clauses**

Contracts with large retail groups generally make use of clauses designed to prevent franchisees from exercising a similar activity to that of the network they are leaving.

### **Example:**

"The operating company is prohibited from directly or indirectly exercising a commercial activity similar to and/or concurrent with the one that it is operating, from the address of its principal establishment and within a radius of 15 km around the latter for a period of one year from the expiry of the effects of the agreement, for any reason whatsoever,"



In franchise agreements, so-called non-(re)affiliation clauses require franchisees who leave the network, not to use for a specific period the signs of a competing network of international or regional renown and not to offer for sale goods under a brand linked to such a network in a given territory.

**Example:**

"The operating company is prohibited from directly or indirectly exercising a competing commercial activity under a trade name of national or regional renown and from offering for sale products whose trademarks are linked to that trade name, from the address of its principal establishment and within a radius of 15 km around the latter for a period of one year from the expiry of the contract, for any reason whatsoever."

- Requirements to qualify for block exemption (Art. 5.3 BER 330/210: competing goods and services; obligation limited to the premises and land from which the buyer has operated; indispensable to protect know-how; duration limited to one year after termination)
- There have been a number of disputes before the national courts relative to the scope and the validity of such clauses (requirement of proportionality, and limits in time and space)
- Some national laws intend to prohibit this type of clause (Macron Bill in France, raising issues of compatibility with EU law)

## **B. Effects of the termination of the principal agreement on the other contracts**

- Choices must be made between separability or inseparability of contracts (e.g.,: clause providing that the termination of the Master Franchise Agreement also results in the termination of the contract between the Master franchisee and the sub-franchisees)
- Here again, possibility of intervention by mandatory rules of national law. e.g.: Macron bill, same duration, term and fate of distribution contracts concluded with the same legal person, to allow operators to switch brands more easily.

## CONCLUSION:

- For a smooth transition, caution is required, great caution:
  - Include contractual clauses ensuring a smooth transition,
  - Ensure that the effective use of those clauses does not infringe national law
  - When the time comes, make sure the use of such clauses can be adapted to what is permitted by law