



International Distribution Institute

TERMINATION FOR CAUSE GENERAL STRATEGY

Silvia Bortolotti

Buffa, Bortolotti & Mathis - Torino

IDI Annual Conference, June 14, 2019 - Cernobbio

TERMINATION FOR CAUSE

In principle, allowed in all jurisdictions, in case of:

- serious breach/default
- exceptional circumstances (performance becomes impossible or excessively burdensome for one party; frustration; etc.)

In some jurisdictions grounds are specifically provided:

- by law (e.g. Australia/franchising; Austria/agency; Brazil/agency; Colombia/agency; Czech Republic/agency; Greece/agency; Kuwait; Portugal; Russia)
- by case-law

Validity and effectiveness of termination to be checked

EARLIER TERMINATION CLAUSE

19.1 Each party may terminate this contract with immediate effect, without respecting a period of notice, by simple communication served in conformity with Article 19, in case of :

- (a) a substantial breach by the other party of the obligations arising out of this contract, as defined in Article 18.2 hereunder, or
- (b) exceptional circumstances justifying the earlier termination, as defined in Article 18.4 hereunder, or
- (c) change of control, ownership and of management, as specified in Article 18.5 hereunder.

MATERIAL BREACH (civil law approach)

19.2 Any failure by a party to carry out all or part of his contractual obligations resulting in such detriment to the other party as to substantially deprive him of what he is entitled to expect under the contract, shall be considered as a substantial breach for the purpose of Article 19.1 above.

19.3 The parties hereby agree to consider in principle, unless the contrary is proved, as a substantial breach of the contract the violation of the provisions under Articles Moreover, the violation of any other contractual obligation may be considered as a substantial breach, if such violation is repeated notwithstanding a request by the other party to fulfil its contract duties.

FRANCHISE AGREEMENTS

(common law approach)

- identifying possible defaults/breaches by each party
- normally, term to remedy
- sometimes, right to terminate only provided for the franchisor

TYPICAL CASES OF MATERIAL BREACH

- Breach of exclusivity
- Competing activity
- Systematic refusal of orders by the principal (agency)
- Repeated lack of payments by distributor/franchisee
- IP violations (franchising)
- Non payment of commissions to agents
- Lack of supply of important information
- Franchisor's lack of sufficient assistance/training
- Lack of achievement of the minimum turnover, in case of exclusive agent (Czech Republic for agency provided by law); lack of achievement of the minimum turnover for distributors/drop of purchases
- Violation of know-how/confidentiality/trade secrets obligations (franchising)

EXCEPTIONAL CIRCUMSTANCES

19.4 Circumstances in which it would be unreasonable to require the terminating party to continue to be bound by this contract, shall be considered as exceptional circumstances for the purpose of Article 19.1 above. The parties agree to consider as exceptional circumstances which justify the earlier contract termination by the other party the following situations: bankruptcy, moratorium, receivership, liquidation or any kind of composition between the debtor and the creditors, or any circumstances which are likely to affect substantially one party's ability to carry out his obligations under this contract.

CHANGE OF CONTROL (intuitus personae)

19.5 If the Distributor is a company, this contract may also be terminated by the Supplier with immediate effect at the occurrence of a material change of the legal structure, of the shareholders or of the management of the Distributor company, carried out without the prior consent of the Supplier, and particularly where one of the persons indicated in Annex .. ceases to have the position therein indicated or anyway ceases to personally take care of the relationship with the customers.

HOW TO PROCEED WITH TERMINATION

In some jurisdictions, it is required:

- to specify the grounds of termination in the termination letter
- to terminate within a reasonable term after acknowledgment of the circumstance (Belgium 7 days; Finland; Italy; Germany, Mozambique, Portugal: 1 month; Switzerland: few days)
- other possible aspects to be verified

VALIDITY AND EFFECTIVENESS

In most countries earlier termination clauses are valid, but subject to control by the Courts.

As far as the effectiveness is concerned, they can be:

- immediately effective (i.e. when the communication of termination is received)
- termination to be declared by the competent Court
- subject to notification of the breach, giving the chance to remedy (e.g. Austria; Denmark; Germany; Paraguay: 120 days)
- to be registered at the IP Authority (e.g. franchising in Russia)

Possible agent/distributor's right to goodwill indemnity

CONSEQUENCES OF AN UNLAWFUL TERMINATION

- compensation claim
- continuation of the contract (e.g. Australia/agency; Austria: decision to be taken immediately after termination; Czech Rep.; Germany; Greece/franchising; New Zealand/distr.; UK/distr: at the choice of the distributor; USA: protection for the franchisee)
- how to enforce a possible Court order/interim injunction to continue performing the contract?

CONTRACTUAL CLAUSE

18.6 Should a party terminate the contract on the basis of this Article, by invoking circumstances which thereafter appear not to be of such gravity as to justify the earlier termination, the termination will nevertheless be effective, but the other party will be entitled to recover possible damages suffered as a consequence of the unjustified earlier termination. (..)

DAMAGES

General principle: the terminated party should be put in the same position as if the contract had been properly terminated (actual damages, lack of profit, etc.)

Issues:

- Net or gross margin in distribution contracts?
- Obligation to mitigate the loss
- UK: special formulas used for franchising
- Italy (franchising): three years' minimum guaranteed period (for definite periods' contracts), if termination is not for serious breach

LIQUIDATED DAMAGES CLAUSE

18.6 (...) Such damages are presumed to be equal to the average profits the terminated party would have made with the performance of the contract during the period the contract would have lasted in case of normal termination, based on the turnover of the preceding year. However, the damaged party may prove that the actual damage is higher and, respectively, the party having terminated the contract may prove that the actual damage is lower.

Issues:

- No penalty in common law countries
- In most jurisdictions Courts can reduce the amount if excessive (e.g. Egypt; Italy)
- Possible further damages?

STRATEGY

WHEN DRAFTING THE CONTRACT

- Drafting a good earlier termination clause
- Checking the effectiveness of the clause in the counterpart's jurisdiction
- Liquidated damages clause for unlawful termination?
- Coordinating with the jurisdiction/arbitration and applicable law clauses
- Evaluating possible defensive/offensive strategies:
 - agent's/distributor's right to goodwill indemnity?
 - Need to recover credits from the distributor/master/franchisee?

STRATEGY WHEN DECIDING TO TERMINATE

PRINCIPAL/SUPPLIER/FRANCHISOR

- Checking effectiveness of the clause/formal requirements etc. in the counterpart's country (applicable law)
- Checking effectiveness of jurisdiction/arbitration clause
- Economical assessment of the risks
- Giving a term to remedy?
- Proceeding with an unlawful termination?
- Pushing the counterpart to terminate?
- Termination by notice followed by a termination for cause

STRATEGY WHEN DECIDING TO TERMINATE

AGENT/DISTRIBUTOR/MASTER/FRANCHISEE

- Checking effectiveness of the clause/formal requirements etc. in the counterpart's country (applicable law)
- Checking effectiveness of jurisdiction/arbitration clause
- Economical assessment of the risks (losing the right to goodwill indemnity?)
- Pushing the counterpart to terminate?
- A post-contractual non-compete obligation may play a role



International Distribution Institute

THANKS FOR YOUR KIND ATTENTION!

Silvia Bortolotti

s.bortolotti@bbmpartners.com

JOIN IDI!

You can use IDI model contracts and country reports