Managing termination with a distributor in financial difficulty

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Introduction

Under what circumstances could the suspension of supplies by a manufacturer to a distributor in financial distress lead to liability if it results in the distributor insolvency.

- Potential liability depends on the contract terms, the manufacturer's motives, the notice given, and whether the manufacturer acted in good faith.

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Introduction

- Suspension of supply to a financially distressed distributor can create exposure in several ways:

1) Breach of Contract
2) Duty of good faith / honest performance
3) Franchise legislation exposure
4) Wrongful termination or constructive termination

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Introduction

- Manufacturer defenses if:

1) The agreement expressly permits suspension for credit risk or non-payment
2) The distributor is already in default or insolvent
3) The manufacturer acted consistently and commercially reasonably
4) Adequate notice and opportunities to cure were provided
5) Continued supply would materially increase the manufacturer's credit exposure

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Outline of Discussion

1) How local laws affect the decision to take action that may place distributors into financial distress or bankruptcy
2) Potential claims distributors may advance against manufacturers in these circumstances and their enforceability
3) The relevant bankruptcy and insolvency laws in order to minimize brand damage
4) The availability of security and enforcement mechanisms for securing obligations

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Outline of Discussion

5) Governing law and arbitration considerations in cross-border distribution relationships
6) Practical remedies to avoid marketplace disruption

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Topic 1: How local laws affect the decision to take action that may place distributors into financial distress or bankruptcy

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Topic 1 (Pakistan): How local laws affect the decision to take action that may place distributors into financial distress or bankruptcy

Legal Framework at a Glance

- **Contract Act, 1872 :** Governs agency & distributorship; termination rights as per contractual clause.
- **Companies Act, 2017:**

i. S.302: Court winding-up on undisputed debt.
ii. S.347: Voluntary winding-up — members' or creditors' voluntary liquidation.
iii. S.426 + Easy Exit Scheme: Private/public unlisted company with no known assets & liabilities may apply to the Registrar to strike its name off the Register, without formal winding-up.

- **Corporate Rehabilitation Act, 2018** : Prioritises revival; distressed distributor may seek court protection & restructuring plan.
- **Provincial Insolvency Act, 1920 :** Applies to individual distributors facing personal insolvency.

Q1 — Effect of Local Laws on Principal's Decisions

- Pakistani courts can assume jurisdiction if a cause of action arises locally — even if the principal is abroad.
- Under Contract Act 1872, the principal has an inherent right to terminate a distributor failing financial obligations.
- Courts do not issue injunctions forcing an "unwilling principal" to continue — remedy is damages only.
- Under CRA 2018, a distressed distributor can seek court protection & propose a revival plan, temporarily restraining enforcement or initiate proceedings for its winding up under the provisions referred above.

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Topic 1 (Belgium): How local laws affect the decision to take action that may place distributors into financial distress or bankruptcy

Legal Framework:

- General contact law
- 1184 Civil Code (Enac)
- Insolvency law (WCO)
- Abuse of law (if manifestly disproportionate to the alleged breach or risk; or is exercised without legitimate interest)
- Law on economic dependency (relative market power)

- Freedom of contract (to suspend performance, to terminate the cooperation)
- even without contract clause: ENAC (suspension)
- No obligation to keep distributor alive
- But limits! Not recommended:
  - contract termination (prohibited under WCO)
  - public announcements
  - aggressive stock buy-backs
  - forced repayments
  - supplier-imposed asset sales
  - using “strict compliance” as a pretext after years of tolerance

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Topic 1 (Serbia, Montenegro, Bosnia and Hercegovina, North Macedonia): How local laws affect the decision to take action that may place distributors into financial distress or bankruptcy

Legal Framework:

- **Law on Obligations** (1978/ amd.)
- **Insolvency law**

Serbia *("Sl. glasnik RS", br. 104/2009, 99/2011 - dr. zakon, 71/2012 - odluka US, 83/2014, 113/2017, 44/2018, 95/2018 i 44/2025 - odluka US)*

Montnegro

BiH

NM

- **Competition law**

Serbia*("Sl. glasnik RS", br. 51/2009, 95/2013 i 35/2026 - dr. zakon)*

Montnegro

BiH

NM

Exceptio non adimpleti contractus (ENAC) -Law on Obligations /Art.123/:

- Right to SUSPEND SUPPLIES
- Right to demand SECURITIES, if not …
- TERMINATION

Freedom of contract

- Definition of "*financial difficulties" as*
- Securities
- Limitations by *good faith principle*
- Limitations by competition law

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The Suspension of Supplies (Law on Obligations, Art 123 – uncertainty of performance / right to postpone or terminate)

If after the conclusion of the contract the **financial circumstances of the distributor worsen to such an extent that it becomes uncertain whether the distributor will be able to fulfill its obligations**, or if such uncertainty arises from **other serious reasons,** the supplier may postpone its performance until the distributor fulfills its contractual obligations or provides sufficient security that it will do so.

This applies even when the financial circumstances of the other party were **equally difficult before the conclusion of the contract, if the contracting party was** not aware of it and could not reasonably have been expected to know (***bona fides / good faith***).

In such cases, the **supplier may demand that security** be provided within a reasonable period of time, and if that period expires without result, he is entitled **to terminate the distribution contract**.

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Freedom of Contract

If the distributor is in financial difficulties, **but not to the extent that questions the fulfillment of distributors contractual obligations**, the Law on Obligations does not provide for right to suspend supplies.

FREEDOM OF CONTRACT - PERMISSIBLE CLAUSES

Contractual clauses in the distribution contract, defining *"financial difficulties" a*nd the right of the supplier to use the *"suspension of supplies"* mechanism, *securities* and *termination* are recommended.

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The Suspension of Supplies – Permissible contractual clauses

Examples:
- "If circumstance arise which ***impair the distributors creditworthiness*** *or damage distributors financial standing to such an extent that the regular continuation of its business operation is jeopardised or no longer possible (and the distributor fails , despite receiving a warning notice, to remedy such circumstances within a reasonable deadline stipulated by the Supplier) …"*

- "If the distributor loses part or all of its control over the operating facilities*…"*

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Termination for good cause based on Law on Obligations (analogy as for Agency agreements, Art. 811 Serbia, BiH/904 Montenegro/867 N. Mac.)

Termination for good cause – without termination notice (analogy as for Agency agreements, 811 Serbia, BiH/904 Montenegro/867 N. Mac.).

Advise: «GOOD CAUSE» to be defined by contractual clauses.

For example,

*«The distributor becomes insolvent or itself applies for the **opening of insolvency / pre-insolvency proceedings** (BIH) or insolvency proceedings are opened or rejected for lack of assets or a reorganisation plan is issued.»*

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Topic 2: Potential claims distributors may advance against manufacturers in these circumstances and their enforceability

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Topic 2 (Belgium): Potential claims distributors may advance against manufacturers in these circumstances and their enforceability

- Liability for causing/contributing to bankruptcy (insolvency law)
- Claim for injunction relief and damages
- In practice: rarely granted
- Point of attention: general mandatory law protection the Belgian distributor in case of termination (Book X.III Code of Economic Law)

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Topic 2 (Serbia, Montenegro, Bosnia and Hercegovina, North Macedonia): Potential claims distributor may advance against suppliers

Performance of obligations - with the care as required in course of transactions for the specific type of contract **: care of a good businessmen, supplier in distribution.**

A party is required to refrain from conduct that would make it more difficult for the other party to perform its obligations. Law on Obligations, Art. 18 SRB/BIH, 11 MG, N.Mac)

Always, under *the good faith principle!*

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Potential claims distributor may advance against suppliers

- Investments performed upon instructions of the Supplier
- No depreciation of investments
- Sudden / wrongful termination

➢ Good faith principle (duty to inform in long term agreements)

➢ Damages for loss and lost profits (not goodwill)

➢ No court practice

➢ Aviodance of transactions under insolvency law (**active role in reogranisation before insolvency** / Pharma Industry Case, Serbia 2014)

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Topic 2 (Pakistan): Potential claims distributors may advance against manufacturers in these circumstances and their enforceability

Possible Claims:

- Breach of contract (sudden / wrongful termination)
- Damages for lost profits, goodwill & business opportunity
- Misrepresentation (investments made on assurances)
- Injunctive relief to restrain termination

Enforceability Reality:

- Very limited — courts strongly favour principal's termination rights.
- Injunctions rarely granted; damages are the remedy and the quantum of damages is difficult to establish.
- Even substantial inventory investment does not guarantee an automatic injunction.

Key Cases:

Capitol Travels (GSA) v Air France & Others — Islamabad High Court: Claim for injunction and damages was dismissed; principal's termination rights were upheld.

Pakistan Automobile Corp v General Motors Overseas — PLD 1982 Karachi 796: Rs. 48.5M in inventory; court still declined injunction. Termination upheld.

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Topic 3: The relevant bankruptcy and insolvency laws in order to minimize brand damage

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Topic 3 (Serbia, Montenegro, Bosnia and Hercegovina, North Macedonia): How to minimize brand damage?

- Aftersales functions
- Employees
- CI elements

➢ Cooperation with the insolvency administrator + customers/ dealership network

➢ Active role in reorganisation during insolvency – share or asset deal / sale in insolvency to a new distributor

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Topic 3 (Pakistan): Bankruptcy & Insolvency Considerations and how to minimize brand damage

Individual Distributor (Provincial Insolvency Act 1920):
Must produce full books & records; failure = rejection of petition & no discharge certificate.
Case: Navaid Ahmed Siddiqui v Official Assignee — PLD 2012 Kar 522

Corporate Distributor:
S. 302 Companies Act 2017: Undisputed debt + statutory demand + commercial insolvency test.
CRA 2018: Revival first; courts appoint Coordinator/Mediator.
Cases: Hala Spinning Mills v IFC — 2002 SCMR 450; Askari Bank v Khawaja Flat Glass — 2025 CLD 1176.

Winding-Up Checklist:
Undisputed Debt → Statutory Demand → Commercial Insolvency Test → No genuine dispute.

Note: *Winding-up petitions must not be used as a pressure tool where the debt is genuinely disputed.*

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Topic 3 (Belgium): How to minimize brand damage

- As a supplier, stay closely involved in view of constructive solutions towards
  - customers and
  - a possible transfer to a new distributor
- Prepare communication to customers
- Control the Corporate Identity (and removal)

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Topic 4: The availability of security and enforcement mechanisms for securing obligations

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Topic 4 (Pakistan): The availability of security and enforcement mechanisms for securing obligations

A distressed distributor may be obliged to: (i) provide full accounts & statements; (ii) assign receivable debts from third parties (with consent); (iii) furnish bank guarantees; (iv) provide surety/indemnity bonds by guarantors for outstanding amounts.

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Topic 4 (Belgium): The availability of security and enforcement mechanisms for securing obligations

- Contract terms (financial reporting, ROT, pledge, credit limits, right to change payment and delivery terms, audit rights, termination events, etc.)
- Monitor and make sure there is a paper trail (warnings etc).
- Appointment of legal sequestrator (for safeguarding stock)
- Preconditions for vehicle documents release (cooperation with bank or escrow)
- Consignment of products
- Direct invoicing the customer
- Security for (a rato for one month supplies) P&A deliveries
- Always: legitimate interests , proportionate and reasonable notice (transition)

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Topic 4 (Serbia, Montenegro, Bosnia and Hercegovina, North Macedonia): Enforceable Securities - Priority in Insolvency

- **Pledge** on movables or receivables + public register : out- of court sale (no receiver necessary)
- **Retention of title** : assets do not form part of the insolvency estate, if the contractual clauses are notarised (SRB, MG, Bih) and entered into the public registry (Serbia)

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Topic 5: Governing law and arbitration considerations in cross-border distribution relationships

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Topic 5 (Belgium): Governing law and arbitration considerations in cross-border distribution relationships

- Freedom of choice (clauses are in principel valid)
- But Belgian laws may prevail when bankrupt estate is located in Belgium (property law, insolvency law)

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Topic 5 (Serbia, Montenegro, Bosnia and Hercegovina, North Macedonia): Governing law and arbitration considerations in cross-border distribution relationships

- Freedom of choice of governing law
- National law prevails for property/securities/ insolvency for dealers located in the respective country (property law , insolvency law)
- Arbitration clauses valid
- NY Convention applicable / enforcement

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Topic 5 (Pakistan): Governing law and arbitration considerations in cross-border distribution relationships

- Foreign governing law & arbitration clauses generally respected.
- Jurisdiction cannot be entirely ousted — local cause of action keeps Pakistani courts relevant.
- Arbitration agreements enforceable; courts may stay proceedings in favour of arbitration.
- Pakistani courts may still grant interim relief where local rights are affected.

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Topic 6: Practical remedies to avoid marketplace disruption

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Topic 6 (Serbia, Montenegro, Bosnia and Hercegovina, North Macedonia): How to minimize the risk for the Supplier?

- ✓ **Enforceable securities** under national applicable laws / pledge, ROT
- ✓ **Contractual clauses** related to suspension and termination of distribution contract in case of financial difficulties
- ✓ **Communicati**on and written **evidence during performance** – *good faith in performance*
- ✓ **Arbitration clauses** advisable / no court practice in the region /NY Convention is applicable
- ✓ **Foreign governing law** applicable/ no mandatory overriding provisions under national law related to **goodwill** and it may be excluded
- ✓ **Good faith principle** cannot be excluded / overriding mandatory rule and principle of the Law on Obligations (civil law countries)

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Topic 6 (Pakistan): Practical remedies to avoid marketplace disruption

- Clear Contractual Terms — explicit termination procedures, notice periods, financial thresholds.
- Adequate Notice — reduces wrongful termination exposure.
- Providing a clause in the agreement for periodical performance report and termination of distributorship if after the notice, targets are not met.
- Appointment of new distributor for continued supplies in the market.
- Financial Controls — credit limits, advance payments, account reconciliation.
- Negotiate / Mediate First — preserves relationships & brand reputation.
- Local Law Compliance — courts are principal-friendly but require procedural correctness.

Contractual & Management Strategies (Additional)

In the distributorship Agreement structure the distributor as an independent contractor (buyer-reseller), — the distributor purchases goods outright and resells them. This is the most secured protection if the distributor fails to pay or goes insolvent, alternatively title retention/ROT clause may be incorporated; assignment of receivables, transfer of goods to new distributor ; bank guarantee/surety bond to clear the outstanding amount for the supplies; audit rights; automatic termination on insolvency event.

Case: World Wide Trading Co. v Sanyo Electric Trading Co. — PLD 1986 Karachi 234.

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Topic 6 (Belgium): Practical remedies to avoid marketplace disruption

- Temporary continuation of supply under tightened but predictable conditions (e.g. reduced volumes, shorter invoicing cycles)
- Document credit-risk rationale
- Avoid stock-building
- Controlled customer reallocation or temporary direct-to-customer model

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