Ordine degli Avvocati di Milano

CRINT

Commissione Rapporti Internazionali
Ordine degli Avvocati di Milano

TERMINATION OF FRANCHISING AND DISTRIBUTION AGREEMENTS IN EU

a cura di
Alberto Venezia

e-book gratuito

MVLTA PAVCIS AG Giuffrè Editore

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GIUFFRÈ EDITORE

ISBN 9788814228520

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PRESENTAZIONE

Con questo terzo ebook dedicato ai contratti di concessione di vendita e franchising nell'Unione Europea, si completa il ciclo di studi comparatistici che l'Ordine degli avvocati di Milano e la Commissione rapporti internazionali hanno deciso di realizzare sui contratti di distribuzione.

Come già avvenuto nel primo ebook dedicato al trattamento di fine rapporto nei contratti d'agenzia. Sono stati coinvolti numerosi colleghi di ordini forensi europei per la trattazione della disciplina nazionale dei singoli Paesi membri di appartenenza. Il diritto italiano è stato trattato dall'avv. Alberto Venezia, membro della nostra Commissione rapporti internazionali. Lo stesso si è occupato anche di coordinare l'intera opera per entrambi gli ebook.

L'ordine avvocati di Milano e la Commissione rapporti internazionali hanno in programma la realizzazione di ulteriori ebook dedicati alla trattazione di temi di interesse nazionale ed internazionale per sviluppare i rapporti di cooperazione e condivisione delle esperienze professionali con il maggior numero possibile di ordini di Paesi europei.

Si rinnova dunque lo sforzo formativo del Consiglio dell'Ordine, anche per il tramite della Commissione rapporti internazionali, per la messa a disposizione gratuitamente dei colleghi e di chiunque acceda al nostro sito di uno strumento di agevole consultazione e ampio respiro al fine di fornire i principali elementi connessi alla redazione e gestione di contratti nazionali e internazionali di agenzia, franchising e concessione di vendita, con particolare riferimento alla fase terminale del rapporto.

Con i nuovi temi in programma, di interesse nazionale e internazionale, il Consiglio dell'Ordine intende fornire sempre maggiori e più aggiornati strumenti di formazione e informazione che potranno essere di aiuto a colleghi e imprese impegnati nella gestione e soluzione di sempre nuove problematiche.

avv. Remo Danovi
Il Presidente del Consiglio dell'Ordine degli avvocati di Milano

HEADINGS

With this third ebook dedicated to distribution and franchising contracts in the European Union, we compete the cycle of comparatistic studies that the Milan Bar Association and the International Commission have decided to implement on distribution contracts.

As set out in the first ebook dedicated to the termination indemnity In commerciaI agency contracts, several colleagues of European Bar Associations have been involved to treat the national discipline of individual member countries. The Italian law was treated by avv. Alberto Venezia, member of our International Commission. Alberto Venezia also took care of coordinating the entire work for both the ebooks.

The Milan Bar Association and the Intemational Commission are planning the realization of further ebooks dedicated to topics of national and international interest, to develop the relations of cooperation and sharing of professional experience with as many European Countries as possible.

It is therefore renewed the formative effort of the Milan Bar Association, also through the International Commission, making available free of charge for colleagues and anyone who accesses our site of an instrument of easy consultation in order to provide the main elements related to the drafting and management of national and international commercial agency, franchising and distribution contracts, with particular reference to the termination of the relationship.

With the new topics to be treated, of national and intemational interest, the Milan Bar Association intends to provide more and more updated training and information tools that will help colleagues and companies engaged in the management and solution of ever-new problems.

Avv. Remo Danovi
The President of the Council of the Milan Bar Association

PREFAZIONE

Tenendo fede ai propri impegni, la Commissione Rapporti Internazionali dell'Ordine Avvocati di Milano (CRINT) giunge con questo lavoro alla terza pubblicazione che rende accessibile a tutti, avvocati e non, di Milano e non, con un semplice "clic" una essenziale tematica, necessaria alla odierna formazione del professionista legale.

La pronta e spontanea collaborazione dei Colleghi degli Ordini del Belgio, Spagna, Olanda, Germania, Austria e Regno Unito conferma l'interesse per il tipo di Opera che viene offerta, ed il piacere di tutti di collaborare con l'Ordine di Milano, e più specificatamente con la nostra Commissione, e, nel caso che ci occupa, con il coordinatore dell'Opera stessa, ossia il Collega Alberto Venezia.

Riteniamo che l'Ordine degli Avvocati di Milano e la CRINT, con tutti i propri componenti, possano essere fieri del lavoro svolto, che conferma l'importanza e la centralità della città di Milano, nonché la caratteristica e lo spirito precorritore di questo Ordine, per tutta Italia, nell'ambito dei rapporti internazionali.

La pubblicazione uscirà in concomitanza con un importante evento/convegno per la presentazione dell'Opera, occasione di lavoro durante la quale parteciperanno tutti i redattori dei vari testi, provenienti dai vari Paesi.

È volontà di CRINT proseguire in questo tipo di pubblicazioni, gratuite e di libero accesso, intese ad affrontare con un taglio internazionalistico tematiche oramai non più affrontabili in ambito e con conoscenze meramente domestiche, stante la inevitabilità di valutazioni comparatistiche.

MARIO DUSI
Presidente delegato CRINT
Commissione Rapporti Internazionali dell'Ordine Avvocati di Milano

INTRODUCTION

Franchising and Distribution agreements complete the framework of the most important distribution contracts utilized together with commercial agency in EU national and international distribution networks.

Differences between individual national legislations of European Union countries dealing with Franchising and Distribution, given the absence of a dedicated EU Directive, are certainly more relevant than the agency contract.

Also in this ebook, after a brief analysis of the two contracts, concerning definitions used in the various countries and general discipline, we decided to concentrate our view on the duration of the contracts and on their termination, dealing also with all the problems and particularities concerning the end of the relationship, and the rights of both parties that is to say termination indemnity, stock of unsold products, possibility to resell, notice period and so on.

Of relevant interest in this regard, except for Belgium, who has a specific law expressly dedicated to distribution contracts and which provides for a termination indemnity due to the distributor provided that specific requirements are met, is the tendency of some countries of the European Union (Germany, Austria and Spain) to provide the distributor's right to a termination indemnity applying by analogy the provisions stated for the different and typical commercial agency contract, provided that certain conditions exist. Italy, on the contrary has not, up to now, made any jurisprudential opening in this sense, even if a future adaptation of the jurisprudence cannot be excluded, considering that in the past (Cass. 18/9/2009, n. 20106) Italian Court of Cassation already stated in a truly innovative (and questionable) way dealing with the legitimacy of a termination with notice, in a permanent motor vehicle distribution contract. Particularly Italian Court considered abusive a termination made respecting the notice period contractually provided for, but breaching the general principle of objective

good faith, assuming that the termination was made according to reasons other than those for which the contractual provision was made.

Also Franchising contract has been analyzed in depth both from a legislative and from a jurisprudential point of view, concentrating on duration, termination and pre contractual disclosure requirements which we found present almost in every legislation of European Countries.

The most important legislative and jurisprudential discipline of European Union has been analyzed (Italy, Austria, Germany, United Kingdom, Netherlands and Spain) without pretension of completeness but with the aim to give an overview of the correct way to conclude and terminate a distribution or franchising national or international contract, bearing in mind the basic consequences from an economical and juridical point of view.

This ebook, usable for free by all Bar members involved in the project, and not only, simply accessing on the websites of one of the Bar involved and particularly on the Milan Bar Association - International Commission website, is strictly linked to the first ebook dedicated to termination of commercial agency contract and ideally completes the treatise dedicated to termination of distribution national and international contracts in the European Union. A future publication can be foreseen dealing with antitrust consequences on distribution contracts and vertical restraints.

Alberto Venezia
Lawyer in Italy, Milan - founder albertoveneziaavocati law firm - www.albertovenezia.com - info@albertovenezia.it

Chapter I

TERMINATION OF FRANCHISING AND DISTRIBUTION AGREEMENTS IN ITALY

by *Alberto Venezia* (*)

1. Preface.

The aim of this contribution is to provide a synthetic and exhaustive framework regarding the Italian Law about two of the most relevant and widely used distribution contracts existing in the European Union: Franchising and Dealership Contracts.

After an examination of the general structure and the regulation of the contracts, I am going to focus on the duration and the termination of single contracts, and on the subject matter regarding the right of a franchisee and of a dealer to termination indemnity. This subject matter is not regarded in Italian Law which doesn't even mention it. However, it appears relevant in relation to what happens in other European Union Member States (themes treated by other authors involved in drafting other national chapters of this e-book), where a

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(*) *Lawyer in Italy, Milan - founder albertoveneziaavvocati law firm - www.albertovenezia.com - info@albertovenezia.it*

settled jurisprudence has been developed through which, in certain circumstances, is made an application by analogy of regulations provided for commercial agency contract (1). In Italy, as it is hereinafter analyzed, it is not possible to see a similar case however, we cannot exclude that, in the wake of the events in the other European Union Member States, will occur a future adjustment on behalf of the Italian Supreme Court.

1.1. Franchising and Dealership within distribution contracts' category.

Franchising and dealership contracts are fully pledged part of the category, created by Academic Literature (2), of distribution contracts formed by contractual instruments, which are adopted by the producer/supplier of goods or services in order to spread them, through business intermediary, employees, partners or other independent business organizations (sometimes organized in real distribution network) to reach final consumers in different ways.

Commercial distribution is characterized, on the one hand, by a

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(1) I refer to what is happening in Germany, where a settled jurisprudence provides in favour of the dealer the right to obtain termination indemnity as provided for commercial agency contract: the application of the herein Law is so common that a various number of interpretative judgements from the European Court of Justice, applying EU Directive 18 December 1986, n. 653 about commercial agents, come from German judgements concerning duration and termination of distribution contracts. See to conduct a thorough examination of the duration and termination of commercial agency contracts in the European Union, the e book *Il trattamento di fine rapporto nel contratto di agenzia*, *https://www.ordineavvocatimilano.it/index.php?pgn=articolo&id=3697&idm=214* . Cfr. also on the same subject in academic Italian literature F. Toffoletto, *Il Codice Civile Commentario - Il contratto d'agenzia - Artt. 1742-1753*, IV ed., Giuffrè, Milano, 2014 e *Il contratto di agenzia*, Giuffrè, Milano, 2012; Trioni, *Contratto di agenzia*, in *Commentario al codice civile,* Scialoja Branca, a cura di Galgano, Bologna, 2006; F. Bortolotti, *Manuale di diritto della distribuzione*, Cedam, Padova, 2007; A. Venezia - R. Baldi, *Il contratto di agenzia. La concessione di vendita. Il franchising.*, IX ed., Giuffrè, Milano, 2015; A. Venezia - M. Ferraris, *Guida Pratica: Agenti e rappresentanti*, Il Sole 24 Ore, Milano 2010; A. Venezia, *Gli Strumenti contrattuali per le reti di vendita*, Ipsoa, Milano, 2004.

(2) Cfr. R. Pardolesi, *I contratti di distribuzione*, Jovene, Napoli, 1979; and more recently A. Venezia, *Gli strumenti contrattuali per le reti di vendita*, Ipsoa, 2004, p. 5 e ss.; A. Venezia, *Distribuzione commerciale e disciplina antitrust*, in *Riv. Comun. Scambi int.* 2007, p. 75 e ss. and A. Venezia - R. Baldi, *Il contratto di agenzia. La concessione di vendita. Il franchising*, mentioned in footnote above.

necessary and functional connection between the producer/supplier of goods and services and market, and on the other hand by a relating integration process between companies, which could be differently organized due to producer/supplier distribution policy and the consequently contractual instrument used.

Commercial distribution, in its economic structure, has been substantially changed during the years. As consequence, besides the traditional contracts, new ways of cooperation between companies appeared which have given birth to non-typical contracts developed on the precedents and on the new economic needs.

This process was possible in Italy thanks to the presence in the Italian Civil Code of the Art. 1322, which providing the openness of its content, has lent legitimacy to all those contractual forms borrowed from custom that were in compliance with general principle of Law.

So, next to nominate figures such as sale contract, supplying contract, commercial agency contract and contract under which commission is payable, other innominate contractual figures developed, and more precisely: dealership contracts (and its own variation, among which there is the selective distribution, based on qualitative and quantitative choice criteria and on the prohibition to sell products outside the network to third unauthorized retailers) and franchising contract, whose development in the commercial practice is undeniable and which finds a specific regulation in 6 may 2004 Law, n.129 "Norme per la disciplina dell'affiliazione commerciale" (3).

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(3) In *G.U.* n. 120 del 24 maggio 2004. See for an overall comment about new jurisprudence G. De Nova, C. Leo, A. Venezia, *Il franchising*, Ipsoa, 2004; A. Venezia, *Gli strumenti contrattuali per le reti di vendita*, mentioned in footnote 1, p. 157 e ss.; G. De Nova, *La nuova legge sul franchising*, in *I Contratti* 2004, p. 761 e ss.; A. Frignani, *Franchising. La nuova legge*, Torino, 2004; A. Venezia, *La fase precontrattuale nella nuova legge sul franchising*, in *Agenti & rappresentanti di commercio*, n. 4/2004, p. 25 e ss.; C. Vaccà, *Franchising: una disciplina in cerca di identità*, in *Contratto e Impresa* 2004, p. 870 e ss.; G. Colangelo, *Prime note di commento alla normativa in materia di franchising*, in *Corriere Giuridico* 2004, p. 851 e ss.; M. Cian, *La nuova legge sull'affiliazione commerciale*, in *Le Nuove Leggi Civili Commentate* 2004, p. 1153 e ss.; L. Delli Priscoli, *Franchising, contratti di integrazione e obblighi precontrattuali di informazione,* in *Riv. Dir. Comm.* 2004, p. 1163 e ss.; F. Bortolotti, *Il contratto di franchising,* Cedam, 2004; E. M. Tripodi, V. Pandolfini, P. Iannozzi, *Il manuale del franchising*, Milano 2005; G. D'Amico, *Il procedimento di formazione del contratto di franchising secondo l'Art. 4 della legge 129/2004*, in *Riv. Dir. Priv.* 2005, p. 769 e ss.; L. Guerrini, *Sulla violazione degli obblighi di informazione in materia di affiliazione commerciale*, in *Contratto e Impresa* 2005, p. 1263 e ss.; A. Venezia, *Responsabilità del*

In commercial practice, there are also other contractual hybrid types, which are difficult to classify inside one contractual structure, especially if referring to innominate figures, which are justified due to the accommodating nature of the innominate contracts.

However, it is certain that each contractual figure depends on a specific economical or commercial demand, which is not always fixed but prone to define adjustments and evolutions. This makes extremely difficult to accurately classify.

Italian case Law, even if interested in a massive way on contractual phenomenon related to commercial distribution, has not drawn up any accurate juridical category inside which it is possible to include distribution contracts. Even the Academic Literature, dealing with this phenomenon, had difficulties in the identification of a single category which can include all the figures somehow related to modern commercial distribution. Part of the Academic Literature (4) states that is possible to create a specific contract distribution category with consequent application of laws present in an agency contract or in different contracts of the same nature or category. Such thesis has not found a confirm yet (except for the dealership contract to which are applied some of the laws regarding supplying contracts) in case Law.

The above-mentioned difficulties to identify a unitary category are also related, to the structure itself of distribution contracts that, by definition, are intended for regulating a complex and variable realty, that is difficult to bridle in rigid juridical definition.

From a practical point of view, Italian case Law, in order to solve the numerous problems related to each particular case submitted to its exam, turned on the one hand to general principles, regulating drafting and contracts execution, and on the other hand to analogy criteria which means using Law provisions fixed for nominate contracts similar to the examining ones. In particular the Italian case Law referred to the

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franchisor nei confronti dei terzi per comportamenti del franchisee (nota a C.A. Napoli 3/3/2005), in *I Contratti* 2005, p. 1133 e ss.; AA.VV., *L'affiliazione commerciale*, a cura di V. Cuffaro, Torino, 2005; A. Dassi, *Il contratto di franchising*, Cedam, 2006; V. De Gioia, *Il franchising*, Forlì, 2006; A. Frignani, *Il contratto di franchising (Orientamenti giurisprudenziali prima e dopo la legge 129 del 2004)*, Giuffrè, Milano, 2012, with a complete overview of decisions and arbitration awards; FICI, *Il contratto di franchising*, Edizioni Scientifiche Italiane, Napoli 2012; e ID., *La qualificazione del contratto di franchising*, in *Riv. dir. priv.* 2009, p. 75 e ss.

(4) R. Baldi, in cooperation with A. Venezia, *Il contratto di agenzia. La concessione di vendita. Il Franchising*, 7ª ed., Milano, 2001, p. 22 e s.

regulations provided for contracts conferring a mandate, supplying contract, sale contract, procurement contract and for the figures of mixed purpose contract, regulatory contract and framework contract.

Another interesting aspect through the scrutiny of dealership and franchising contracts is the evolution of the Italian case Law attitude towards the qualification of contractual relationship, in particular referred to *nomen iuris*, that is the qualification of the relationship as pointed out by the parties at the moment of the contract drafting.

The transition from an orientation based exclusively on the evaluation of the concrete methods of the contractual relationship implementation, to a major, or even predominant value given to the literal meaning of the contract signed by the parties, was a significant change.

Lack of consideration to *nomen iuris* is given in the Law 129/2004 about franchising, where in an explicit way (Art 1.1) it is specified that in order to qualify the contract of franchising the name used by the parties is irrelevant. The reason beyond this clarification is recognizable in the characteristics themselves of the Law in general, that focuses in the major part on the pre-contractual negotiation and in particular on the duty of *disclosure* burdening on the franchisor. It is made clear through that reference of the worthless of the name used by the parties, the anti-circumvention nature of the regulations, giving priority, on the contrary, to the concrete method of executing the contract relationship.

The less recent case Law was inclined to consider the legal name (*nomen iuris)* used by the parties in order to define their relation as a mere name, giving more importance to the analysis of the real facts emerging from the relation between them (5).

Afterwards, the elements of the issue were reversed, thanks to the appreciation of the literal elements used by the parties in drafting the contract, considered as the fundamental element for the qualification of relationships and likely to be exceeded by the presence of different and unmistakable advices deriving from the exam of their implementation, that could conduct to a different qualification (6).

From a practical point of view, considering the herein criteria

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(5) Cass. 7/12/81, n. 6492, in *Mass. Giur. it.* 1981, 1631; Cass. 6/3/87, n. 2395, in *Mass. Giur. it.* 1987, 367-368; concerning commercial agency Cass. 3/4/90 n. 2680, in *Riv. Giur. lav.* 1991, II, 196

(6) Cass. 23/7/2004, n. 13884; Cass. 30/10/1997, n. 10704, in *Mass. Giur. it.* 1997, 1061-1062; Cass. 20/1/1995, n. 649, in *Mass. Giur. it.* 1995, 77-78.

evolution of qualification of contractual relationship made by case Law, the way of drafting the contract and the type of contract used gain more relevance. The latter, subject to his necessary coherence with the previewed concrete development of the relationship and the consequent necessity of an in-depth exam of every single aspect, becomes the fundamental element of qualification.

Another fundamental element, that gains relevance in the choice of the contractual structure to use in order to create a distribution network, more or less structured, is represented by the integration level which the producer/ supplier intend to establish with its collaborators to distribute products and/or services. This integration level must be valued also taking into consideration the producer/supplier's intentions concerning its presence and direct control on the relevant market and the consequently necessary investments to be made.

Every distribution contract has a different purpose and it is therefore related to a different grade of collaboration and integration between the parties. In the innominate contract of dealership (with or without exclusivity) we find a remarkable integration between the parties, a participation of the distributor — dealer to the necessary investments in order to increase the distribution and therefore to a minor control by the producer/supplier on the market.

One of the characteristics of the dealership contract is the direct purchase of goods by the distributor/dealer in order to resale them in the relevant market. The dealer takes on his own the risk of goods resale, usually granting to the producer the purchase of minimum quantities, in return of an exclusive right in a certain area and of the license to use producer's trade names, trademarks and distinctive marks.

The producer ends up losing, almost in part, direct control on the market, on which of course induces effects, but not in a manner as effective as direct distribution or through different distribution contracts such as for example the commercial agency contract.

The dealer has the need of a structure and organization, sometimes very complex, with significant capital investments (7). Similar to the framework of the dealership contract is selective distribution, which

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(7) Therefore he is considered by the antitrust Law as an independent entrepreneur, as such subject to the related limits and prohibitions regarding the fixed pricing, the use of the Internet, the prohibition of territorial protection and market foreclosure.

however is characterized by numerous features, so it is considered as a category on itself.

It is generally used for high technology and high standard products distribution, in which the distributor has a relevant role in order to safeguard on the one side an appropriate assistance, pre and post-sale, and on the other side an image in line with the characteristics of the product and the distribution network.

The distribution is entrusted exclusively to people chosen on specific qualitative basis, settled by the manufacturer. As in the case of dealership, the selective distributors purchase goods to resell them, even if they are subject to a massive control by the manufacturer. This control, however, has to be respectful of the autonomy and independence of the distributors.

Inside the selective distribution formula, it is possible to identify some figures materially different one another and characterized by general criteria that the manufacturer aims to apply to its own sales network.

Because of the characteristics of this kind of distribution, the purchases of products to other intermediaries not belonging to the sale network are generally forbidden, and it is also provided the necessity that the distributor gives specific services to the consumers both before and after the sale.

With this kind of distribution form, it is implemented a certain integration between manufacturer and distributor, with even more control by the former on the relevant market and with a selection of the distributors based mostly on technical-qualitative criteria.

The contract with a most intense degree of integration between manufacturer/supplier and the distributor is the franchising contract. Somehow similar (almost in some of its version) to the contract of dealership, it is characterized by a higher degree of interpenetration between manufacturer/supplier (franchisor) and distributor (franchisee).

The franchising contract was born in the USA and appeared on the European scene from the Sixties, when it established itself as a new instrument of distribution network growth between the Eighties and the Nineties.

The franchising contract is characterized by a massive flexibility and it is mainly used in two areas: distributive (divided, according to the object, into franchising related to product distribution and to services) and industrial.

Generally speaking, it is possible to underline that the application of franchising contract is based on the creation by the franchisor (in other words, by the party who wishes to create and develop its own distribution network) of a real entrepreneurship structure dedicated explicitly to the creation, the management and the development of a franchising network. The franchising network highlight, as I said, a strong integration between the franchisor and the franchisee or affiliates. The latter are included into the network, consequently they will benefit for example of the exploitation of the same image or distinctive marks, the possibility of application procedures and technical and commercial know-how developed by the franchisor and constantly upgraded, also with the experience of the other franchisees, members of the same network.

The know-how and its transmission is, in my opinion, one of the most important features of the franchising contract, because it helps to diversify it from the other distribution contracts.

In the franchising contract, as well as in dealership, the franchisee is an independent company which allows the franchisor to consolidate his presence in the market and to make the distribution of its own services and goods very extensive without massive investments, even if, as I said, the creation of a network (with pilot sales points, the creation of a business plan and a packet of franchising) and its development need of course important investments.

In return the franchisor is generally provided with a remuneration, which is added to the indirect advantage of the commercialization of its own goods and services and of the continuous dissemination of its own trademarks and distinctive marks and the growth of market share held.

Finally, beside franchising, in the international relationship the figure of master franchising (to which is expressly applicable the Law 129/2004, "Norme per la disciplina dell'affiliazione commerciale" (8)) has spread. The master franchising contract is an agreement between the franchisor and another subject whose job is to develop the franchising network in a particular area (generally consisting of a foreign country, where the franchisor could find some difficulties trying to enter directly).

In conclusion, I can confirm that among the distribution contracts, the franchising contract is the relationship in which is implemented the

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(8) Provided that the master franchising contract would be subject to the Italian Law.

collaboration and integration between manufacturer and/or supplier of goods and services and the distributor with most intensity. In particular the franchising contract adapts in an extremely incisive way to the services distribution, sector in which we can see in the last years a continuous growth.

2. The Franchising Contract: Characteristics and Types.

The franchising contract is very similar to the exclusive dealership contract (9). Common to both contracts are the granting by one main company (grantor-franchisor) to another autonomous and independent company (dealer-franchisee) to have the possibility to develop a commercial activity, that is part of the object and activity of the former, in tight collaboration protracted over time.

While the exclusive dealership contract works only in the products distribution field, the franchising contract works also in the service and manufacturing one. Moreover, the franchising has as a basis, the license of a trademark of given products or services from the franchisor to the franchisee, in order to allow the latter to sell products or services for third parties using the trademark. So, this element, with the transfer to the franchisee of using distinctive marks, patent licenses and know-how, characterizes the franchising contract.

The possibilities of the franchising contract application are numerous and different; therefore, it was difficult to find a precise definition of it in the past. It is essentially a tight form of collaboration between two independent companies (franchisor-franchisee), which complement each other through the products distribution or the services presentation between franchisor and franchisee.

The presence of different elements which are recalled even in the EU Regulations has contributed to constitute different types of franchising, certainly before the Italian legislator gave an exact definition in the Law 129/2004 (10), that provides a specific regulation about the

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(9) See to the necessary evaluation of the collaboration and integration level existing between the parties, subject to the essential role in the know-how transfer A. Venezia, *Gli strumenti contrattuali per le reti di vendita*, mentioned in footnote 1, p. 5 e ss.; Sega, *Franchising e concessione di vendita a confronto*, in *Arch. civ.*, I, 2001, p. 3 e ss. e part. p. 7.

(10) See for further information the Academic Literature as in footnote 3.

phenomenon, incomplete and focused on the pre-contractual negotiation.

Before my focus on the new Law, it is relevant to make a first classification, underlining that Italian legislator considered to exclude the so called industrial franchising from the field of operations of the Law 129/2004. In general, as above mentioned, the franchising contract can be classified as: distribution franchising, manufacturing or industrial franchising and services franchising. The distribution franchising is the most popular and it creates a direct relationship between the products manufacturer and the retailer.

The manufacturer or franchisor creates a chain of franchisees, independent, coordinated between them, using trademarks, signs and manufacturer know-how, selling each one in his own area the latter products, avoiding therefore other possible intermediaries. The franchisee generally pays to the franchisor an entry fee for the network admission, and royalties or a remuneration during the contract for using the know-how, trademarks and signs and for every other element transmitted by the franchisor.

The distribution franchising has developed in Italy in the sectors of fashion, furniture, book industry, textile, food, soft drinks, electrical appliance, fast food, tour operator, real estate, mass retail channel with the exception of food, internet-communications and so on.

The industrial or manufacturing franchising is a kind of both industrial and commercial partnership: in respect of a franchisor-manufacturer there is a network of franchisee to whom is allowed with the trademark license also the manufacturing license. Therefore, the franchisees produce and sell products with the franchisor trademark. This category is not very widespread, however is the case of Coca Cola in Italy and of Yoplait in France.

Finally, the franchising contract is really different from the dealership contract in the sector of the service performance, spread mostly in the sectors of hospitality, real estate, car hire, beauty salon and so on. The main characteristic of this category is the circumstance that the franchisee does not sell any product (unless it is second to the kind of services provided) but offer originals services due to a program and a method standardized and provided by the franchisor. Even in this case we can see a know-how transfer, emphasized in the hospitality sector, where the visual identity is substituted with the standard identity.

As mentioned above, it is typical in a franchising contract to have a fixed amount paid by the affiliate consisting of an *upfront fee* that,

variable in its amount, to be paid at the beginning of the relationship as consideration of the right to be admitted in the network.

In Italy such fee is paid in half of the contracts and in some cases is substituted by a bank guarantee. In other cases, no up-front fee is required. Beyond the latter during the contract, it is usually paid to the franchisor a royalty due to the permanent support and the image. This is generally a fixed amount or a rate (or additional charge) on the products bought by the franchisee or on the turnover achieved by him.

The franchising is characterized by a tight collaboration between franchisor and franchisee, and to achieve it the franchisee generally must follow numerous instructions and conditions (among them there is for example a minimum target of sales, which is also typical of many dealership contracts) requested by the franchisor and in particular the provisions provided in the so called operating manual. The franchisor, as consideration, transfer to the franchisee distinctive marks and other identifying elements of the franchisor company, patent licenses, technical knowledge and inventions of processing (the so-called know-how) and provide to the franchisee technical assistance, business advice, staff education and training. On the contrary, the franchisee generally undertakes the effort, if the contract concerns the sale of products, of buying minimum quantities of goods.

Franchising wants to be seen, from a strictly economical and business point of view, as an alternative to the application of great amount of money for the distribution, allowing an independent business activity to the franchisee even in poor economic conditions. In other words, the franchisee invests small amount of money with tight risks, thanks to the fact that the franchisor is the owner of well-known marks. However, the franchisor achieves the goal of spreading in a capillary way the image of his own trademark and business organization, thanks to his franchisee network; while the consumer gains the advantage of having products and services with attractive prices and professional assistance.

2.1. National Regulations: Law 129/2004.

In Italy, after a long period without written regulations and consequently the application of general principle as provided by the civil code regarding contracts and laws provided for typical contracts as they can be observed each time in single cases, it was perceived the need of a specific Law. Therefore, followed a series of different

legislative drafts, then unified, ratified by the Senate on the 21th April 2004, and then transformed in the Law 6 May 2004, n. 129 "Norme per la disciplina dell'affiliazione commerciale" (11) (Italian Law on Franchising Contracts). It is a short Law, made of 9 Articles, only about some aspects of the phenomenon, with a particular attention to the pre-contractual negotiation. However, it provides provisions, starting from the definition of the contract itself, intended for having an influence on both the contracts ongoing when it entered in force and the following ones.

The 129/2004 Law was later fulfilled by the (decreto ministeriale 2 settembre 2005, n. 204 (12)) that, as provided for by Art. 4.2 of the Law 129/2004, has focused on the content of some of the *disclosure* obligations for the franchisors previously operating only abroad.

The atypical nature of franchising, as well as its application in many different sectors and with different characteristics, as above mentioned, made the individuation of a precise definition extremely difficult in the past. With the final approval of the 129/2004 Law "*Norme per la disciplina dell'affiliazione commerciale*", and from May 25th 2004, when it entered into force (13), the definition of franchising contract is provided in article 1, which also clarifies the meaning of essential concepts as know-how, entry fee, royalties and goods of the franchisor.

Generally, the Franchising contract is defined as « *the contract, regardless of its name, between two juridical subjects, economically and juridically independent, by which one of the parties makes available to the other, for remuneration, a package of industrial or intellectual property rights regarding trademarks, business names, signs, utility models, designs, copy right, know-how, patents, technical and commercial assistance or advice, entering the franchisee into a system made of several franchisees widespread on the territory, in order to market certain goods or services* ».

The more recent pronunciations by the Courts align with this definition.

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(11) See on that point the Academic Literature as in footnote 3.

(12) D.m. 2 settembre 2005, n. 204, *Regolamento recante norme per la disciplina dell'affiliazione commerciale di cui all'articolo 4, comma 2, della legge 6 maggio 2004, n. 129*, (*G.U.* n. 231, 4 ottobre 2005*, Serie Gen.*), in *I Contratti* 2005, p. 1161 e ss., with comment of A. Frignani, *Il Regolamento che definisce gli obblighi dei franchisors esteri*. Cfr. for a deep analysis A. Venezia, *Il completamento della normativa italiana ed i contratti internazionali di franchising*, in *I Contratti* 2006, p. 995 e ss.

(13) Without prejudice to transitory dispositions, Art. 9.

Some of the fundamental franchising characteristics are confirmed: that is to say it is an onerous (for remuneration) and bilateral contract, signed between economically and juridically independent legal entities.

The contract's object is the granting, for consideration, of the availability of industrial and intellectual property rights (related to trademarks, trade names, signs, utility models, designs, copy rights, know-how and patents) and also technical and commercial assistance or advice from the franchisor to the franchisee.

Another main characteristic deriving from the contract's definition is the admission of the franchisee in the franchising network ("system made by several franchisees") distributed in the territory.

The spacial distribution is broadly identified, in order to avoid that the territory size covered by the network becomes an implicit limit to the qualification of the relationship as a franchise contract. In other words, it is enough that the franchisees are variously located on the territory, without any kind of limitation.

Art. 1, second subparagraph, underlines that there are no limitation to the franchise contract regarding the economic field involved, even if a limit can be deducted from the last part of the first subparagraph, from which it seems that the industrial franchising is excluded, that normally disregarding from the inclusion of the franchisee in a system constituted by several franchisees and, at least in part, from the scope as indicated in paragraph 1, constituted by the commercialization of goods and services.

The definition, and consequently the Law application, is limited to the distribution and service franchising.

Continuing the subject of Law application, Art. 2 includes the master franchising contract, named "*contratto di affiliazione commerciale principale*", having as object the granting of the right to exploit a franchise, in order to conclude franchise contracts with third parties. It is also underlined that the Law applicability is extended to the contract through which the franchisee set up a space ("corner") inside an area of its own availability, in order to conduct an exclusive business activity as indicated in Art. 1, paragraph I of the Law, where you can find the franchising contract definition.

Lastly, as already mentioned dealing with the qualification of the phenomenon, in the contract definition it is underlined that *nomen iuris* is meaningless. The name of the relationship used by the parties is overlooked, as it is developed in practice, in which it is not so common to find the name "franchising", even considering that until the 129/

2004 Law approval, the relationship had not a specific regulation and was considered as an atypical nature contract.

Moreover, in Art. 1, as provided in the past in the franchising contract's definition of the EU Regulation 4087 of the 30th November 1988, it is clarified with precision the meaning of the four essential contract's elements.

- Know how
- Entry fee
- Royalties
- Franchisor's goods

The **know-how** consists of commercial and technical knowledge, not patented or not patentable, which is transmitted by the franchisor to the franchisee.

The Italian Law no. 129 / 2004 used the same definition of know-how already used in the past by the EC Exemption Regulation on franchise no. 4087/88 (14); the mentioned Italian Law also stated (on Article 3 lett. e) that the franchise contract should provide with the procedures for granting in favor of the franchisee the value of the contribution the latter has brought about the know-how and its updating.

Know-how, as mentioned above, is one of the essential and distinctive features of the franchise contract (15), whose transmission from the franchisor to the franchisee (even from franchisee to franchisor) is what differentiates it from other distribution contracts, considering the franchise network characteristics.

Know-how is made up of all the knowledge of the franchisor, deriving from his experience that he makes available to the franchisee. Therefore, the know-how must be secret, substantial and identified. The concept of know-how confidentiality used is deliberately wide: secret know-how is a know-how that, as a set of notions or in the precise configuration and composition of its elements, is not generally known or easily accessible. In addition, the know-how must be substantial, that is to say that it must include the knowledge to be considered essential to the franchisee for the use, sale, resale, manage-

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(14) Know-how is defined as "a patrimony of practical and non-patented knowledge derived from experience and attempts made by the franchisor; such patrimony is secret, substantial and ascertained".

(15) In this sense see the professional and academic literature, A. Venezia, *Gli strumenti contrattuali per le reti di vendita*, mentioned in footnote 1, p. 158.

ment or organization of the goods or contractual services. Finally, the know-how must be identified and described in an enough precise manner to allow the verification of the existence of the two previous requirements of secrecy and substance.

The franchisor's remuneration paid by the franchisee is also subject to precise regulation by Law 129/2004. A first form of remuneration in favour of the franchisor, which is discretionary and not always provided, is constituted by the "entry fee" which is usually paid after signing the contract and before its performance. The entry fee is due for the affiliation of the franchisee in the franchisor's commercial network. The Italian Law (Article 1.3 (b)) provides that this part of the franchisor's remuneration is constituted of a fixed amount, related to the economic value and to the network development capacity. Italian Law do not provide a precise parameter for its quantification, whereas it states that its payment is made at the time of the contract's closing.

Again, with reference to the franchisor's remuneration, the royalties paid by the franchisee to the franchisor are defined by the Italian Law: they correspond to a percentage proportionate to the affiliate's turnover or they are determined in a fixed amount. Lastly, royalties can also be paid by the affiliate in regular periodic fixed quotas.

Finally, article 1, third comma, (d) of Law 129/2004, recovering the same definition from Regulation 4087/88, defines the assets of the franchisor as the goods it produces or that are produced according to its instructions and marked by the franchisor's name.

Law 129/2004, after providing the written form as an essential requirement of the contract's validity (Article 3.1), governs the content of the agreement, leaving however to the parties wide contractual discretion.

A minimum three-year duration is foreseen if the contract has a fixed term of duration, while no provision is made in the case of indefinite term contract.

It is also provided a general rule that imposes the obligation on the franchisor to have experimented his business formula on the market in order to be able to establish an affiliate network.

Such provision is generic, but it is evident that the franchisor aspirant needs to develop the formula through direct experimentation, by opening direct sales outlets or by using different contractual formulas, characterized by smaller constraints and charges against its collaborators.

Article 3.4 finally lists the following terms, which must be necessarily indicated in the contract:

— the investments to be made before the beginning of the franchise business, including any Entry fee to be paid to the franchisor;

— royalties, to be paid by the franchisee during the franchise business, specifying its determination and payment modalities;

— the possible existence of an obligation for the franchisee to achieve a minimum turnover;

— the possible existence of a territorial exclusive right in favour of the franchisee, both with reference to the other franchisees and with reference to the franchisor, also in order to assess the potential for investment development and the costs required for entry and stay in the franchise network;

— the know-how's characteristics to be transmitted to the franchisee;

— the modalities, if they are provided, by which the franchisee's contribution to know-how will be enhanced by the franchisor;

— franchisor's role in planning, setting up, training and technical and commercial assistance;

— the terms and conditions for renewal, termination and assignment (where permitted) of the contract.

The core of Law 129/2004 is the rules governing the pre-contractual phase, contained in Art. 4, which provides rules and obligations falling on the franchisor to be observed before the conclusion of the contract and which should give the potential franchisee a deeper knowledge of the franchisor's proposal, prior to signing the contract. In this regard, the franchisor is obliged to deliver a full copy of the contract to the potential franchisee at least 30 days prior to the contract's closing.

In addition to a brief report on the main elements of the activity of the franchise business and the franchisor's company information, including also the share capital, the potential franchisee has the right to request a copy of financial statements of the franchisor regarding the last 3 years or from the beginning of its activity if it is less than 3 years old. Pursuant to Article 4.1 b), the contract will indicate accurately the trademarks used in the franchise sales system, as well as the elements from which the ownership of such trademarks may be deduced and the legitimacy of their use by the franchisor.

A further set of provisions concerns the existing franchisee network and direct sales points, in order to assess the presence of the franchisor's formula on the reference market. It will also be necessary to specify in the contract the variation and location of the franchisees over the last three years or from the beginning of the franchisor's

business activity, if the latter is less than three years. Finally, a concise report of legal disputes promoted against the franchisor, both before the Court or through arbitration procedure, which has been terminated over the last three years, will be enclosed to the contract, as far as such disputes are linked to the franchise sales system being evaluated by the potential franchisee.

Nevertheless, all information concerning franchisees (referred to article 4.1 (d), (e) and (f)) ([16]) may only relate to the activities carried out by the franchisor in Italy, regardless of any reference to its condition in international area. Such limitation regarding the information that can be transferred from the franchisor will certainly not provide the potential franchisee with a complete and exhaustive framework of the situation.

([16]) Art. 4. (franchisor obligations): « 1. At least thirty days before the franchising contract is signed, the franchisor must provide the franchisee with a full copy of the contract to be signed, with the following attachments, with the exception of those for which there are objective and specific confidentiality needs and which should be mentioned in the contract:

a) principal data relating to the franchisor, including company form and share capital, and, upon request of the potential franchisee, a copy of its financial statements for the last three years or from the date of the beginning of its business if it has been commenced for less than three years;

b) the indication of the trademarks used in the franchising sales system, the relevant details of their registration or deposit, or the license granted to the franchisor by a third party having the same trademark's ownership, or the documentation proving the actual use of such trademarks;

c) a brief illustration of the relevant elements that characterize the franchisor's business;

d) a list of franchisees currently operating in the franchising sales system and of direct sales outlets;

e) the indication of the year-by-year variation of the number of franchisees with their location in the last three years or from the date of the beginning of their activity, if it has been less than three years old;

f) a concise description, in accordance with the current privacy policy, of any judicial or arbitration proceedings related to the franchising commercial system in question, brought against franchisor from franchisee or from third parties or from public authorities and concluded in the last three years.

2. In the Annexes referred to in points (d), (e) and (f) of first comma, the franchisor may provide with information on the activities carried out in Italy only. With a decree of the Ministry of Productive Activities, to be issued within 90 days from the date of entry into force of this Act, the information, referred to in the letters (d), (e) and (f) mentioned above, to be provided by franchisors which previously operated exclusively abroad, shall be identified ».

2.1.1. Mandatory Application of Law 129/2004: Exclusion.

The article 9 of Law 129/2004 states that the Law must be considered applicable to all of the ongoing franchise contracts in the territory of Italy on the date of entry into force of such Law, thus raising an issue of interpretation related to the sphere of effectiveness of the relative provisions.

Such rule, if intended to give the Italian Law provisions the value of mandatory rules of Law, would not allow the application of the general principle of freedom in the choice of applicable Law (as provided by EC Regulation 593/2008 of 17 June 2008 on the Law applicable to contractual obligations) to international franchise contracts in which the franchisee carries out its activity in Italy.

The Article 3 of the above mentioned Regulation confirms the previous provisions of the Rome Convention of 1980 and, specifically, it states that the choice of the parties (17) is the main criterion for the regulation of international contracts and it also allows them to identify the Law applicable to one part of the contract and even after its conclusion (18).

Pursuant to the mentioned legislation and to articles 16 and 17 of Law 218/95 on the reform of International private Law, if the parties have chosen a particular Law governing an international contract, the related provisions will be applicable unless they are contrary to public policy (19) or they result in conflict with any national mandatory rules of national Law, that is, those rules that must be applied in any case regardless of the Law governing the contract.

Therefore, the attribution of the aforesaid meaning to the provisions of l. 129/2004 (as mandatory rules of Law), such provisions would be applied to all international franchise contracts where a choice of applicable Law has been legitimately made, on the basis on a merely territorial reason consisting in the pursuit of business in Italy.

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(17) Notwithstanding what is stated in the Rome Convention, in the event of no-choice on applicable Law of the contract, article 4.1. let. (e) identifies as Law applicable to the international franchising contract, the Law of the country in which the franchisee has his habitual residence.

(18) Without prejudice to the need for the chosen Law to be connected to the specific case.

(19) To be understood in the sense of international public policy, that is to say all the principles that must be considered indispensable for national Law system in the light of the economic, social, moral and political characteristics of the Law system itself.

Nonetheless, in my consideration, Article 9 of Law 129/2004 does not allow the attribution of the aforementioned features to that provision, as confirmed, even though indirectly, by the second *comma* of Art. 1 of the Ministerial Decree n. 204/2005 (20). As a matter of fact, the Ministerial Decree states that its scope is limited to cases in which the contract is subject to Italian Law.

Referring to international contracts, such provision clarifies that the Ministerial Decree will apply only where the contract is governed by Italian Law, in accordance with the principles established in the rules of international private Law.

Therefore, for the applicability of Italian Law, it is not sufficient carrying out in Italian territory the franchisee's activity in favor of a franchisor operating up to then abroad, but it is necessary that the franchise contract is governed by Italian Law in application of the relevant rules of international private Law.

This precise provision, linked to the normative nature of the aforementioned Ministerial Decree, is clear in excluding an implicit qualification of the rules referred to in Law 129/2004 as mandatory rules of Law. If the latter rules (Law 129/2014) were to be considered as mandatory rules of Law, the Ministerial Decree would apply to all contracts to be executed on Italian territory regardless of the Law governing the contract which the parties have chosen. The legislative choice made by the Ministry, however in accordance with the opinion given by the Council of State, was instead not to consider the rules of Law 129/2004 as mandatory, with the consequent application of the Ministerial Decree only where the franchise contract is governed by Italian Law on the basis of our rules of international private Law.

On the other hand, article 9 of Law 129/2004 (21) is a simple transitional rule and it is not able to attribute particular features to the whole Law. Therefore, it must be excluded that under the provision at

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(20) Ministerial Decree September 2nd 2005, n. 204, mentioned in footnote n. 12.

(21) Art. 9 *Transitional and conclusive rules:* « 1. The provisions of this Law apply to all franchising contracts in progress in the territory of the State on the date of entry into force of the Law. 2. Franchising agreements concluded before the date of entry into force of this Law, unless stipulated in accordance of Article 3, paragraph 1, must be formalized in writing pursuant to the provisions of this Act within one year from the date of entry into force of this Law. Within the same deadline, contracts concluded in writing before, must be adapted to the provisions of this Law. 3. This Law comes into force the day following its publication in the Official Gazette... *omissis* ».

issue there is a particular interest in protection of the franchisee, qualifying as weaker party of the contractual relationship, since the legislative provision is intended solely to regulate the Law's effectiveness over time without any expectation of attributing to the whole Law particular characteristics.

As said above, the right interpretation to be given to the provision in question is that Law 129/2004 must apply to those franchise contracts ongoing in the Italian territory at the time of its entry into force, provided that they are governed by Italian Law.

Therefore, in the case of international franchise contracts, the application of Italian Law will not derive from the qualification of the provisions contained in Law 129/2004 as mandatory rules of Law, but it rather derives from the application of the ordinary principles and rules of international private Law, to which the aforementioned legislation has not made any variations.

2.2. Network belonging and appearance principle.

Cooperation between franchisor and franchisee is stronger than that which exists between manufacturer and dealer. The franchisee is part of the franchise chain with the obligation to conform and present itself as the "image" of the franchisor to give the impression of identifying him with the figure of the franchisor outside.

The mentioned "identification" that characterizes the franchisee's membership to the franchise network may lead to a liability of the franchisor on behalf the franchisee related to obligations arising from the contract (like an agency agreement).

The third party has the burden of proof on its reliance with no fault, since there is no doubt about the franchisee's autonomy: it is therefore necessary for the third to provide proof that he has relied with no fault in a different apparent situation that misled him. In this regard, it must be underlined the legal and economic autonomy and independence between franchisor and franchisee, which is an essential element of this contractual formula and which can certainly not be called into question on the basis of simple network membership or image uniformity that the same network would be able to determine (22). In other words, without

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(22) Contra in case-Law, Court of Appeal of Naples, section III, March 3rd 2005, in *I Contratti* 2005, p. 1133 e ss., with comment by A. Venezia, *Responsabilità del franchisor nei confronti dei terzi per comportamenti del franchisee*.

prejudice to franchisor's power and obligations of control and supervision, both in the choice of the franchisees to be appointed and in their actual activity, I cannot adhere to the interpretative attempt made by the Jurisprudence to consider the franchisor liable for franchisees' conduct in force of the simple belonging to the franchise network.

From a practical point of view, it is appropriate for the franchisor to carry out accurate prudential checks on potential franchisees and periodic audits of the activity of the network members, mainly in order to ensure uniformity of its image as well as the quality and service standards offered (which, as is known, constitute the strengths of the franchise contractual formula).

However, I do not agree with the interpretative hypothesis regarding franchisor's jointly liability for franchisee's conduct based on the franchisor's omission of controls, both on the basis of the proper functioning of the principle of appearance and in light of the content of the franchise Law provisions. In fact, such provisions, far from imposing on the franchisor particular control burdens, provide a prior communication obligation to the potential franchisee; we could only assume a franchisor's jointly liability only where the latter failed to adequately assess information received from the potential franchisee.

In conclusion, two types of preventive actions can be adopted in order to avoid the event of jointly liability for the franchisee's conduct: more precisely, from a contractual point of view, by including contract provisions that require the franchisee to disclose its legal and economic independence in respect of the franchisor and, from an operational point of view, with the adoption of internal audit and control procedures.

2.3. Economic Dependency Abuse.

An interesting topic to deal with, regards the possibility of application of the principle contained in Art. 9 of the Italian subcontracting Law ([23]), which regulates the so-called "abuse of economic depen-

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([23]) Law 18 giugno 1998, n. 192, in *G.U.* 22 giugno 1998, n. 143; Art. 9 Economic dependency abuse: "*1. The abuse by one or more companies of the condition of economic dependence in which a client or supplier company is located against them is forbidden. "Economic dependency" is considered as the contractual and commercial condition of a company that makes it capable of determine an excessive imbalance of rights and obligations in commercial or contractual relations with another company.*

dence", in the context of the franchise contract (and in general in distribution contracts).

The academic literature is partly in favor of the application of the aforementioned principle, even if the case Law seems to adopt a different orientation. This does not mean that the potential applicability of such principle necessarily has a significant impact on franchise relationships.

The existence of genuine hypotheses of economic dependence is indeed quite rare in the context of franchising, given that the requirements of Art. 9 of the l. 192/98 must be ascertained; therefore, in the relationship between two companies, it must be ascertained whether the position of one of these companies is able to determine an excessive imbalance of rights and obligations, to be assessed also in relation to the real possibility for the company disadvantaged to find valid alternatives on the market.

This last requirement is not easily verifiable and is however difficult to prove by the franchisee.

Furthermore, the abuse of the aforementioned position by the franchisor must be demonstrated by the franchisee in order to obtain the judicial declaration of nullity of the corresponding contractual clause.

In the case Law of the Courts of merit there have been some isolated applications of the aforementioned principle even if, although being abstractly conceivable, the applications of such principle certainly do not appear to be easy within the scope of the franchise contracts.

2.4. Duration of the Contract.

The franchise contract may provide for a final term (fixed-term contract) or for an indefinite duration (permanent contract) with the

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Economic dependence is also assessed in light of the real possibility for the company — that has suffered the abuse of such economic dependence — of finding satisfactory commercial and contractual alternatives in the market.

2. *The abuse can also consist in the refusal to sell or in the refusal to buy or in the imposition of excessively heavy or discriminatory contractual conditions without any justification or in the arbitrary interruption of the commercial relations in progress.*

3. The pact through which the abuse of economic dependence is realized is void".

For a first comment on the issue, c.f. De Nova, Chiesa, Delfini, Maffeis, Salvadè, *La subfornitura*, Milano, 1998; Prati, Cardini, *I rapporti di subfornitura*, Milano, 1999.

right of withdrawal at any time for both parties the contract with a prior notice period pursuant to the contracts provisions. However, Law n. 129/2004 deals exclusively with the fixed-term contract, omitting any regulation of the permanent relationship.

This omission apparently leaves the parties free to regulate the permanent relationships with particular reference to the right of withdrawal and the notice period, but instead creates some interpretative problems in relation to the general operation of the principle of amortization of investments made, as provided for the fixed-term relationship.

The franchise contract is usually a fixed-term contract with a duration from three to five years, and in some cases even ten years and it terminates upon expiry of the term; it can be terminated before the final term deadline only in the event of a serious breach of contracts obligations by the non-withdrawing party, with the consequent right of the withdrawing party to seek compensation for damages. If the early withdrawal is not legitimated by a serious breach of the contract by the non-withdrawing party, the latter is entitled to seek compensation for damages.

Often the franchise contract provides for an automatic renewal mechanism for one or more periods, with an equal or different duration compared to the first one. The automatic renewal works if one of the parties does not exercise the right of cancellation (or non-renewal) that must be communicated within specific deadlines to be calculated backwards with respect to the first and to any subsequent deadlines.

The receipt of the cancellation beyond the terms contractually agreed will determine the automatic renewal and the necessary continuation of the cooperation until the new deadline, or alternatively, compensation for damages.

Law 129/2004 rigorously regulates fixed-term franchise contracts (more frequent in practice) establishing (article 3.3) a minimum duration of 3 years and in any case a duration sufficient to allow the franchisee to amortize the investments made. Therefore, on the one hand, any contractual clause establishing duration of less than 3 years will be ineffective, and on the other hand, they must be considered automatically replaced by the minimum of three-year term required by Law.

The functioning of the general principle required by franchise Italian Law, for which the franchisee must be guaranteed the amortization of the investments made, appears more problematic.

This is in fact an extremely general indication, which can be interpreted in relation to the specific individual concrete situations and therefore potentially capable of being used in an instrumental manner. In any case, the early termination due to breach of contractual obligations is allowed as well as the faculty for the parties to provide for express termination clauses also in fixed-term contracts.

Open-ended contracts are allowed, but the Law 129/2004 does not deal with these contracts, thus determining a lack of legislation.

Therefore, it is undisputed that the parties are free to withdraw from the contract at any time, although there is no provision regarding the duration of the notice period to be granted by the withdrawing party.

An interpretative solution on such issue could derive from the use of the analogy criterion in relation to the concept of adequacy of the notice period as provided for by the rules on the supply contract (Art. 1569 of the Italian Civil code), which, however, allow its use only in the case in which nothing is provided by the parties on said notice period.

Therefore, the assessment of the adequacy of the notice period on the basis of the legal provisions of the supply contract seems only applicable in the case in which the parties have not provided for a specific clause on the point (without any prejudice to the applicability of the general principles of fairness and good faith).

Entering into a permanent (no fixed-term) franchise contract with the possibility of withdrawal for each party at any time, granting the agreed notice period (even if it is minimum) is therefore admissible. In this case, however, the need to protect the franchisee contractual conditions, clearly contained in the Law in relation to the fixed-term contract, may be compromised.

Nevertheless, even ignoring the literal text of the Art. 3.3 of the l. 129/2004, the general principle contained therein (in the part in which it refers to a sufficient duration for the amortization of the investments made), could be considered as a limit to be applied also in permanent contracts.

In this way, using the concept of "objective good faith" already applied by the Case Law with regard to dealership contracts ([24]), it

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([24]) Cass., sez. III, 18 settembre 2009, n. 20106, in *Guida al dir.* 2009, n. 40, p. 38 et seq., with comment of Pirruccio; in *Dir. e Giur.* 2009, p. 537 et seq., with the brief comment of D'Acunto - Scudiero; in *Foro it.* 2010, p. 86 et seq. with comment of Palmieri and R. Pardolesi; in *I Contratti* 2010, p. 5 et seq., with comment of D'Amico.

could entitle the franchisee to contest the validity of any notice periods as excessively short even if contractually provided, with the consequent possibility for the franchisee to request compensation for damages in respect of investments made and not amortized due to the reduced duration of the contract. Indeed, this interpretation is a mere hypothesis that has not yet found the support of case-Law and that could even constitute an interpretative forcing on such point. In fact, it cannot be ignored that the Art. 3.3 is extremely clear from a literal point of view: while on the one hand it certainly does not exclude the possibility for the parties to enter into a permanent franchise contract, on the other hand it explicitly limits to the fixed-term contracts the operation of the general principle which imposes to provide a sufficient duration to amortize the investments made.

In any case, the expiry of a contract following a "non-congruous" notice period and/or not in line with the aforementioned general principle ([25]) could never be changed or deferred, otherwise the contractual autonomy of the parties' would be seriously compromised.

In any case, contract's termination without notice, or without adequate notice, gives to the non-withdrawing party only the right to ask for compensation for the damages, given that the legal effect of the withdrawal, which does not allow the latter to claim the continuation of the collaboration (even if in the past there have been precedents in which jurisprudence has been opposed in the opposite direction).

2.5. Immediate Termination Clause and Minimum Sales Volume.

In the franchise contract, the stipulation of an express termination clause ([26]) is certainly admissible, which is one of the methods for terminating contracts (pursuant to Article 1456 of the Civil Code).

With this clause the parties identify one or more contractual obligations considered essential and therefore the breach of which,

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([25]) Assuming that the same is also applicable to permanent contracts: something far from obvious.

([26]) With reference to an in-depth examination of the express termination clause, contract resolution and contract withdrawal in the field of distribution contracts: A. Venezia, *Gli strumenti contrattuali per le reti di vendita*, *cit.* in footnote n. 1, p. 311 et seq.

even for only one of the aforementioned obligations, allows the non-defaulting party to terminate the contractual relationship with immediate effect to be communicated with simple written communication of his intention to want to use such clause.

Considering the typical modality of concluding franchise contracts by acceptance by the franchisee of forms usually prepared by the franchisor, it is clear that the express termination clause will be provided exclusively in favor of the latter, thus guaranteeing him further possibility to terminate the contractual relationship.

The express termination clause is not among the so called unfair clauses and therefore the double subscription for its validity is not required. From a general point of view, the clause in question constitutes a contractual exception to the rules on the contract termination for non-performance of contractual obligations, which allows to exceed the legal requirements regarding the severity of the breach of obligations, as well as that the breach must not be of the minor relevance, in relation to the interest of the non-defaulting party. In fact, the express termination clause allows the party to terminate the contractual relationship with immediate effect in the case of non-compliance with even one of the obligations indicated in such clause, regardless of the aforementioned requirement of seriousness of the breach of the contract.

The seriousness of the breach is presumed by the mere fact of the inclusion of the obligation in the express termination clause and does not allow proof to the contrary. The judge must therefore ascertain exclusively the existence of the breach, without any possibility of assessing the gravity of the breach and its immutability to the part due to his fault which is presumed existing until the proof to the contrary otherwise. There is therefore the inversion of the burden of proof with the burden on the non-performing party to prove the absence of his responsibility even as result of his negligence.

Once the existence of the aforementioned elements has been ascertained, the resolution (however conditioned to a manifestation of the will of the non-defaulting party who must expressly declare his will to use the clause) will have immediate effect and will determine the immediate termination of the contract regardless of its duration.

In order to guarantee the validity of the clause, however, particular attention must be given to its drafting, with precise indication of the in-

dividual contractual obligations deemed relevant by the parties (27), which should be restricted if possible, while any generic reference to all obligations arising from the contract could determine the nullity of the clause.

The functioning of the express termination clause could be limited by an extensive interpretation of article 3.3 of Law 129/2004, in the part in which it states that in any case the fixed-term contract must be provided for a sufficient duration to guarantee the amortization of the investments made.

In fact, in case of termination of the fixed-term contract by the franchisor using the express termination clause, the franchisee may request compensation for damages due to the non-amortization of the investments made.

The same request could also be made in the permanent contract, if the extensive interpretation of the aforementioned principle was adopted, as it is not limited to the fixed-term contract.

Without any prejudice to the concern above highlighted in order to overcome the literal data of the article 3.3 of the l. 129/2004, it should be noted that the aforementioned provision expressly exempts the hypothesis of early termination due to breach of the contract (as it appears logical).

This implies that the general principle concerning the duration of the contract, which must be sufficient to allow the franchisee to repay the investments made, could not be invoked where the contract is terminated by the application of an express termination clause.

In fact, the hypothesis mentioned above would constitute a case of contract resolution due to a breach of the contract, even if determined by a conventional mechanism of contractual resolution. The Article 1456 of the Italian Civil Code (regarding express termination clause) in fact falls within the general discipline of the resolution for breach of contract and therefore its operation is expressly without prejudice by the same article 3.3 of the Law. 129/2004.

A typical obligation, normally included in the express termination

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(27) The lack of payment of royalties by the franchisee in the terms provided by the contract (where such obligation is mentioned in the express termination clause) has been considered cause of termination of the contract with subsequent condemnation of the franchisee to compensation for damages, Trib. Milano 23 novembre 1994, in *I Contratti* 1995, II, p. 504.

clauses (usually present also in dealership contracts), is the minimum turnover to be reached by the franchisee.

Law 129/2004 also provides for these types of clauses (Article 3.4, let. b), referring to a « *minimum income to be realized by the franchisee* », considering them as purely as possible, but with an obligation for the party to indicate the terms expressed in the contract.

These are clauses that require franchisees to reach certain sales and/or purchase volumes.

If the aforementioned clauses are included among the obligations mentioned in the express termination clause, any non-compliance (even if such breach is not particularly relevant or it is not serious) may determine the termination of the contract with immediate effect.

2.6. Contract termination: termination indemnity, non-competing clause and stock.

A relevant issue related to termination of franchising contract concerns franchisee's right to termination indemnity, as well as in the case of commercial agency agreement.

In other words, it must be considered if, in case of termination of franchising contract, franchisor acquires the startup of franchisee and franchisee the right to a sort of compensation. Such evaluation requires the existence of development and supply of customers by franchisee and the injury suffered by franchisee due to termination of franchising contract.

Development and supply of customers is not easy to identify with regard to franchising contract, since generally franchisee takes advantage of franchisor's start up existing at the date of entrance into distribution network.

Franchisee's right of a sort of compensation is easier to identify, since, upon termination of franchising contract, franchisee may not use anymore the investments carried out and he suffers damages concerning the loss of customers. Law 129/2004 does not provide for any provision concerning termination indemnity, excluded under Italian Law. Therefore, there are no positive judgments concerning termination indemnity in franchising contracts.

A related issue to termination concerns the validity of contractual terms related to non-competition clauses after termination: such

clauses are considered valid under Italian Law as well as for dealership contract, in compliance with article 2596 of Italian Civil Code ([28]).

The validity of non-competition clauses after termination must be examined with reference to antitrust regulations, if applicable, and in particular to Regulation 330/2010 concerning vertical agreements.

Article 5 of Regulation 330/2010 concerning vertical agreements restricts the duration of non- competition clauses to one year. Furthermore, such article provides for that non-competition clauses are limited to the premises and land from which the buyer has operated during the contract period and must prove to be essential in order to ensure *know-how* protection transferred by the supplier to the buyer ([29]). Lastly, upon termination of the contract, as well as in the case of dealership contract, the issue concerning stocks with franchisor's trademarks or signs, owned by franchisee, must also be dealt with.

Generally, the contract provides for the mere faculty for the franchisor to repurchase the stock according to predetermined conditions, without prejudice that if franchisor seeks not to exercise such right, the franchisee should be allowed to sell the residual stock providing contractually for a maximum limit on discounts. The same issues concern dealership contracts, examined in the following paragraphs.

3. Dealership Contract: characteristics and atypical nature.

Dealer is an entrepreneur, a trader who draws up a contract with a supplier ([30]) regulating in a particular area all sales on a continuous and regular basis for a fixed term or open-ended contracts.

Generally, such contract provides for an exclusive unilateral or bilateral clause and is a long-term contract, as well as distribution contracts which include commercial agency agreement and franchising contract.

([28]) Article 2596 of Italian Civil Code: "*The agreement restricting competition must be proven in writing [1341, 2725]. It is valid if limited to a specific area or activity, and may not exceed five years [2125, 2557]. If the duration of the contract is not determined or is established for a period exceeding five years, the contract is valid for a period of five years [att. 222]*".

([29]) See for further information A. Venezia - R. Baldi, *Agency contract. Dealership contract. Franchising*, IX ed., mentioned in footnote 1, p. 737 et seq.

([30]) Or with the dealer who uses in turn sub-dealers.

Dealer is an independent entrepreneur from the grantor (legally and economically) — as well as franchisee from franchisor — who acts in his own name and on his behalf — and buys goods from the seller and resells goods to third parties.

There are many similarities between dealership contract and franchising contract, whereas there are many differences between dealership contract and commercial agency contract.

Unlike dealer, commercial agent acts in the name of and on behalf of the principal, promoting the conclusion of sale contracts by the principal to third parties, also in the name of principal when commercial agent is entitled to represent the principal (31).

Dealer, since the beginning of the last century, existed among the framework of commercial distribution, and assumes the entrepreneurial risk selling goods to third parties exempting from such risk the grantor.

Dealership contract can result from a continuing sale relationship in which the dealer agrees with the manufacturer in order to intensify relations with ongoing character in a particular area.

Dealership contract usually provides for an exclusive bilateral clause, with the obligation for dealer to promote the selling of products, to buy minimum quantities of products and to make advertising investments — agreed with grantor — in order to deploy products in the target market.

Dealership contract usually provides for any other contractual clause in order to increase the commercialization of grantor's products.

In dealership exclusive contracts usually, the grantor grants to the distributor the brand license as well as in franchising contract.

Dealership contract is sometimes set in a previous agency agreement in which the agent agrees with the principal in order to obtain the exclusive dealership, purchase on his own name and resell principal's products continuously and permanently.

International agency contracts usually provide for the possibility for the agent to purchase products in order to resell them to customers in the area entrusted to the agent.

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(31) The main differences and similarities between agency contracts and dealership contracts are well highlighted in App. Torino 10 May 2010, in *Foro Pad.* 2011, col. 274 et seq., with note of A. Venezia, *Dealership contract and agency contract: characteristics and termination indemnity*.

In this case the same person is both agent and dealer and the contract brings together different contractual patterns with the associated problems concerning the legal qualification of the relationship solved with prevalence or accessory principles.

In such cases dealer has the same characteristics, even if when the agent becomes dealer the confidence prevails. It should be noted that according to case Law dealership contract provides for an exchange between entrepreneurs (32), whereas agency contract provides for a trusting and legal collaboration.

In dealership contract there is an economic collaboration with trusting elements since dealer is integrated in distribution network. Dealership exclusive contract has no specific regulation and is qualified as a contract of atypical nature (33). There have been various attempts to qualify the dealership contract, also referring to commercial agency contract, so that, in the past dealership contract was considered to be a particular supply contract.

Dealership contract cannot be considered a nominative contract or a particular supply contract since it has too many different characteristics, without prejudice of the possibility to find its regulation by analogy.

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(32) Cass. 21 July 1994, n. 6819, in *Mass. Giur. it.* 1994, col. 630 described it as an atypical exchange contract, while subsequent rulings have highlighted the function of exchange and collaboration between the parties, with the consequent obligation on the dealer to carry out promotional activities, despite the existence of specific contractual clauses in this sense: Cass. 19 February 2010, n. 3990, in *Mass. Foro it.* 2010, col. 174; Cass. 18 September 2009, n. 20106, in *Mass. Foro it.* 2009, col. 1220-1221; Cass. 11 June 2009, n. 13568, in *Mass. Foro it.* 2009, col. 773; Cass. 23 January 2006, n. 1227, in *Mass. Foro it.* 2006, col. 93; cfr. likewise in this sense Cass. 18 November 2005, n. 24460, in *Mass. Foro it.* 2005, col. 1762; Cass. 29 November 2004, n. 22415, in *Mass. Foro it.* 2004, col. 1654; Cass. 1 October 2004, n. 19652, in *Mass. Foro it.* 2004, col. 1484; Cass. 24 September 2004, n. 19198, in *Mass. Foro it.* 2004, col. 1459 and Cass. 28 July 2004, n. 14234, in *Mass. Foro it.* 2004, col. 1118-1119.

(33) See in this sense A. Venezia - R. Baldi, *Il contratto di Agenzia. La concessione di vendita. Il franchising*, mentioned in footnote 1, p. 123 and ss.; A. Venezia, *Gli strumenti contrattuali per le reti di vendita*, Milan, 2004, p. 129; F. Bortolotti, *Manuale di diritto della distribuzione*, vol. II, mentioned in footnote 1, p. 9; D'Alessandro, *Dealership contract: description of the phenomenon and systematic profiles*, in *Giust. civ.* 2002, II, p. 71 et seq.; Sega, *Franchising and dealership contract in comparison*, in *Arch. Civ.* 2001, I, p. 7 et seq.

According to case Law (34) dealership contract is a no-nominative contract characterized by an exchange and cooperation between parties, with a specific obligation for the distributor to promote the sale of the contractual products. According to case Law the contractual structure of dealership contract is a regulatory contract or a framework contract, depending on the clauses of the contracts. In order to identify the restrictions of some rules concerning the supply contract, it is necessary to consider the origin of such contract applied in the past to public bodies, supply of services (fuel, provisions, electricity etc.). The supply contract concerns the sale for essential needs, whereas the sale of products only in order to resell the products bought (as it's the case for dealership contract) is just a hypothesis included in supply contract provisions.

The report to Italian Civil Code (n. 685) specifies that the rules of Law governing the supply contract can be extended by analogy to other contracts that have the same economical function with exclusive clause (35). Indeed, the definition contained in Article 1559 of Italian Civil Code (36), relating to the continuity of performances, highlights the lasting nature of the relationship.

Dealership contracts are characterized by the function of exchange — inherent to supply contracts — and by a component of collaboration — inherent to distribution contracts.

Indeed, dealership contracts are contracts with atypical nature which can be considered in a supply framework, the provisions of which are partially applicable by analogy, while, in other cases, such provisions must be integrated with general principles or by more specific clauses related to other nominative contracts.

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(34) Cass. 19 February 2010, n. 3990; Cass. 18 September 2009, n. 20106; Cass. 11 June 2009, n. 13568; Cass. 23 January 2006, n. 1227; Cass. 18 November 2005, n. 24460; Cass. 29 November 2004, n. 22415, mentioned in footnote 32.

(35) Eventual clause in dealership contract. As already mentioned, the Italian case Law, in the past, considered the dealership contract contained in the draft supply contract. A second approach referred to the mixed contract, with the sale contract requirements concerning the transfer of goods provisions, and of the mandate contract, with regard to the cooperation relationship.

(36) Art. 1559 c.c.: "*The concept. - The supply contract is the contract by which a party undertakes, upon the payment of a price [1561 ss.], to perform, in favor of the other party, periodic or continuous performances [1560]*".

3.1. National Regulations: application by analogy of supply contract regulation.

Some provisions of the Italian Civil Code concerning supply contract are also applicable by analogy to dealership contract. In particular, articles 1559 and 1560 of Italian Civil Code ([37]) concerning supply contract — related to the notion and extent of the supply contract — are also applicable to dealership contracts, even if in dealership contracts the dealer buys products to resell them without finding any limits in the need, unlike the supplier.

Articles 1561 ([38]), 1562 ([39]) and 1563 ([40]) of Italian Civil Code — concerning the determination and payment of the price and the expiry of the individual benefits as an expression of general principles — are applicable to dealership contracts. Article 1564 of Italian Civil Code concerning the termination of the contract for no fulfillment, is applicable to dealership contracts, since it implies continuous supplies and underlines the importance of non-fulfillment (which undermines confidence in the accuracy of the subsequent fulfillment). Furthermore, article 1564 of Italian Civil Code concerning the termination of the contract for no fulfillment, is applicable to dealership contracts, since

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([37]) Article 1560 of Italian Civil Code: "*Entity of the supply contract. - If the amount of the supply is not determined, it must be considered the amount corresponding to the normal needs of the party entitled to it, having regard to the time of the conclusion of the contract.*

If the parties have agreed only the maximum and minimum limits for the entire supply or for the individual services, the party entitled to the supply shall establish, within the aforementioned limits, the quantity due.

If the amount of supply must be quantified with regard to the needs and a minimum quantity is established, the person entitled to the supply is required for the quantity corresponding to the needs if these exceed the minimum".

([38]) Article 1561 of Italian Civil Code: "*The price. - In the periodic supply contract, if the price must be determined according to article 1474 of Italian Civil Code, reference should be made to the expiration time of the individual services and to the place of supply services*".

([39]) Article 1562 of Italian Civil Code: "*Payment of the price. - In the periodic supply the price is paid when the services are performed and in proportion to each of them. In continuous supply contract the price is paid according to the expiration dates of use*".

([40]) Article 1563 of Italian Civil Code: "*Expiry of the individual services. - The expiry of the individual services is assumed to be agreed in the interests of both parties.*

If the person entitled to the supply has the right to fix the expiration of the individual services, he shall indicate the date to the supplier with notice".

it represents the application of the principle provided for by article 1453 of Italian Civil Code and it concerns cooperation obligations related to dealership contracts.

An example concerns the provision of a minimum quantity of goods that the dealer undertakes to purchase periodically. If the dealer took a quantity of goods slightly lower than the ones agreed, and if it is not provided for an express termination clause, he will be only responsible for the damages suffered by the grantor, but he will not cause the termination of the contract, which will only be verified in the cases provided for by article 1564 of Italian Civil Code ([41]).

Article 1565 of Italian Civil Code concerning the suspension of execution of the supply contract ([42]), must be considered to be applicable to dealership contract for the same reasons abovementioned, and also in view of the importance of the trusting collaboration.

Article 1566 of Italian Civil Code concerning the pact preference in favor of the administering party for the conclusion of a subsequent contract for the same object, is certainly not applicable to dealership contracts, since it only concerns the supply of goods for consumption.

Paragraphs 3.2 and 3.3 concern articles 1567 and 1568 of Italian Civil Code on the exclusive and article 1569 of Italian Civil Code on the duration of the contract.

3.2. Exclusive Right.

In dealership contracts, the exclusive right — unlike the agency contracts where the bilateral exclusivity is automatic except for different contractual provisions (Article 1743 of the Italian Civil Code) — is an ancillary and non-essential provision, even if in practice, it represents a point of particular interest for the dealer, especially where there is a minimum of turnover and investments to be made on the reference market. Therefore, the exclusive right must be set forth by contract,

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([41]) Article 1564 of Italian Civil Code: "*Termination of the contract. — In the event of default by one of the parties of contractual obligations, the other party may request the termination of the contract, if the non-performance of the other party is "fundamental" — i.e. material and not merely of minor importance — and may reflect on the other contractual obligations [1455]".*

([42]) Article 1565 of Italian Civil Code: "*Suspension of the supply contract. — If the party entitled to the supply is the defaulting party and the default is minimal, the supplier cannot suspend the execution of the contract without due notice".*

while it must be excluded in the absence of an express provision on the point (43).

Such ipothesy is provided for by articles 1567 and 1568 of the Italian Civil Code on supply contract.

Exclusivity may be bilateral or unilateral and, in particular in the case of bilateralism, accentuates between the parties the cooperation, which is a typical element of distribution contracts, and confirms the main obligations of the dealer, namely those to buy and resell products, through sales promotion activity, also in compliance with Article 1375 of Italian Civil Code concerning the good faith in performance of the contract.

With the exclusive bilateral agreement, the grantor undertakes, in the dealer's area, not to appoint other persons and not to make direct sales, and the dealer undertakes not to purchase from third parties products in competition with those of which he has the concession, as well as not to promote the sale of products in competition and, generally, not to produce them in his own name.

The grantor sometimes reserves the right to make direct sales in the dealer's area by granting him a commission on direct business to make it executed.

The unilateral exclusivity clause implies only the obligation of the grantor or only the obligation of the dealer, generally of the dealer, considering that in the structured networks the contracts are by membership, in the case of unilateral exclusivity only the dealer obligation is required. This is often the case in the second case, a situation similar to that of an exclusive or a single agent: the concessionaire may in fact be contractually obliged not to buy products from third parties whether they are in competition or not (without prejudice to the need for co-ordination of this type of clauses with antitrust Law).

The supply provisions (Article 1568 of the Italian Civil Code) provide for — as a possible contractual clause — the promotional activity, typical of dealership contracts, as confirmed by the case-Law (44).

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(43) Conf. O. Cagnasso, *Dealership contract — Qualification problems* Quaderni Giur. Comm., Milan 1985, p. 21; Scorza, *Dealership contract*, in AA.VV., *Distribution contracts*, by Cassano, Milan, 2006, p. 536.

(44) In this sense, in Cass. case Law 19 February 2010, n. 3990; Cass. 18 September 2009, n. 20106; Cass. 11 June 2009, n. 13568; Cass. 23 January 2006, n. 1227, all mentioned in footnote 32.

The exclusivity provision is closely linked to the existing relationship between the grantor and the dealer in order to intensify the sale of grantor's products. With the exclusivity in his favor, however, the dealer buys a privileged position through a full incorporation into the grantor's network and some sort of territorial, even though not absolute, protection.

Article 1567 of the Italian Civil Code that prohibits to the supplier, in exclusivity, unless otherwise agreed, to manufacture products covered by the contract, it is surely applicable to the dealership contracts, since it concerns the possible distribution of goods that the dealer produces.

3.3. Duration of the Contract.

The dealership contract is a long term-contract, as well as supply contract, and article 1569 of Italian Civil Code implicitly provides for fixed-term duration and explicitly for an indefinite term. Such provision also applies to the distribution contracts — inherent to long-term contracts — in particular to the commercial distribution contracts.

The fixed-term dealership contract will run until the expiration and cannot be subject to early withdrawal from one of the parties, but it may only be terminated due to non-performance.

With regard to the dealership contract for an indefinite period, article 1569 of Italian Civil Code provides for the withdrawal with notice « within the agreed period or in the manner determined by the use or, failing that, in a reasonable time, having regard to the nature of the supply of services ».

Article 1569 of Italian Civil Code is certainly applicable to the distribution agreement, even with regard to "congruity", which will be referred to the individual case.

Since in dealership contracts there are organizational structures, it is sustainable that the period of notice — to be congruent — should be equal or greater than the period of notice in agency contracts.

In the case of withdrawal without notice, if the termination of the contract is due to a serious infringement of the subject who suffered the withdrawal, the contract terminates with a notice of withdrawal and no claims can be invoked against it by the subject who suffered the withdrawal, who can be required to compensate the damages suffered by the withdrawing subject.

If, on the other hand, the failure to notice is unjustified, given its binding effect, the withdrawing subject shall compensate the damages

i.e. the loss of net profits of the dealer for the period of notice if the withdrawing subject is the grantor.

Finally, an interesting decision of the Italian Supreme Court of September 18th 2009 (45) on motor vehicle dealers stated a set of principles relating to the exercise of the right of withdrawal by the grantor, although contractually provided.

Such decision stated that the abuse of the withdrawal right constitutes a sanctionable conduct with the dealer's right to compensation for damages.

The Italian Supreme Court decided to use the criterion of good objective faith, as a specification of the duty of social solidarity provided for by article 2 of the Italian Constitution, which requires the parties to align their actions with the principle of preserving the interests of the other. The good objective faith, to be considered as a "general canon to anchor the conduct of the parties", was then integrated with the principle of "abuse of rights", which occurs when the original scheme of the right is altered in order to attain for purposes other than those specified by the Legislator.

Although the Italian legislation does not provide for a general provision that specifically punish any abusive exercise of its rights, the Supreme Court ruled that the principle of the prohibition of abuse of rights must be regarded as existing and reconstructed in an interpretative and jurisprudential sense by the same Supreme Court in different sectors.

In the case of withdrawal, the use of the principles of good faith and the abuse of rights enabled the Supreme Court to focus the examination of the Court of Appel on the evaluation on the existence of the good faith and fairness principals.

Such decision is particularly important even if the concrete effectiveness will however be assessed on the basis of possible developments in case Law.

3.4. Immediate Termination Clause and Minimum Sales Volume.

In dealership contracts express termination clauses are widely

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(45) Cass., Section III, September 18, 2009, n. 20106, in *Foro it.* 2010, p. 86 and seq. with a note by Palmieri and Pardolesi; in *I Contratti* 2010, p. 5 et seq., with a note by D'Amico.

used, considering general principles concerning the right to terminate the contract for non-compliance with obligation and pursuant to Article 1456 of Italian Civil Code (46).

The characteristics of express termination clauses in dealership contracts are the same of franchising contracts (47). In dealership contracts the express termination clauses make it possible to overcome the seriousness of the breach of obligations established in order to terminate the contract. Such clauses provide for contractual obligations whose breach includes the right for the fulfilling party to withdraw from the contract with immediate effect and the right to compensation for damages suffered.

Unlike the standard termination of the contract, pursuant to an express termination clause there will be no need for a constitutive judgment to establish the existence of a serious breach of Law that legitimizes the termination of the contract.

On the contrary, in such cases the contract will be immediately terminated subject to the evaluation concerning the existence of the breach of the contractual obligations provided for the express termination clause, regardless of the gravity of the infringements and the imputability of the infringement to the other party. However, the imputability of the infringement is assumed to exist in the absence of proof to the contrary which must be provided by the defaulting party, with a substantial reversal of the burden of proof.

In dealership contracts express termination clauses are generally linked to the compliance with the terms of payment of the supplies made by the grantor to the dealer, as well as the compliance with minimum annual — or less contractual periods — purchasing obligations.

In compliance with the principles of good faith in concluding and performing the contract pursuant to Article 1375 of the Italian Civil Code (principles that are particularly important in dealership contracts, where the trust relationship is essential), the dealer's obligation to reach

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(46) See on the issue concerning the lawfulness of the termination of a distribution contract for the non-fulfilment of contract obligations regarding the minimum turnover provided for by an express termination clause, Arbitration Award of 2006, in *Comm. Int.* 2009, n. 5: the sole arbitrator stated that, even though the termination of the contract is lawful, the refusal by the grantor to execute the last order (received before the interruption of the cooperation) constituted a failure.

(47) See the previous paragraph 2.5.

a minimum purchase quantity must meet the obligation of the grantor to provide him with this minimum, save in exceptional justified cases. For the same reasons and principles, the dealer cannot refuse, except for a justified reason, to sell to the dealer the required goods, even beyond the minimum purchase contractually established.

3.5. Termination of the Contract and Termination Indemnity.

The Italian legislator, as well as Italian case Law, did not regulate the termination indemnity concerning dealership contracts. However, dealer's right to termination indemnity could be theoretically based on the same reasons concerning termination indemnity in commercial agency contracts (48), i.e. that dealer brought the grantor new customers or has significantly increased the volume of business with existing customers and the injury suffered by the dealer with regard to the loss of customers and incurred expenses and investments. However, there is no evidence of a new opinion of case Law on this matter.

As above mentioned, German, Austrian and Spanish case Law consider equivalent the agent and the dealer, upon the fulfilment of specified requirements (49). Therefore, in Italian Law the right to termination indemnity could be recognized in agency contracts where the agent is authorized to make purchases on its own name as dealer. In such cases the calculation base of termination indemnity could be extended to affairs increased by the distributor. However, case Law has a different opinion on such matter.

3.6. Stock and the Right to Repurchase.

The issue concerning stock upon termination of the contract concerns dealership contracts, as well as franchising contracts. Clauses related to minimum turnover are usually included in dealership contracts, so that stock can be significant, especially if a contract has been

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(48) See on the point the first E book dedicated to the termination of the agency contract *https://www.ordineavvocatimilano.it/index.php?pgn=articolo&id=3697&idm=214,* and A. Venezia - R. Baldi, *Il contratto di Agenzia. La concessione di vendita. Il franchising*, IX ed., mentioned in footnote 1, p. 319 et seq.

(49) In this respect, see the chapters II, IV and VII of this e-book concerning the respective countries.

terminated on the grounds of non-compliance with obligations and /or for an express termination clause.

Clauses concerning the right of the grantor to re-purchase a part or the entire stock are common in Italian contracts, provided however that the stock is in an excellent state of conservation and in its original packaging. Such clauses are lawful, but in the event that the grantor renounces the right to re-purchase, the dealer's right to resell the products in the contractual area — while supplies last — cannot be excluded.

In general, the resale methods, as well as the prices to be applied, cannot be fixed by the grantor, also with regard to the prohibitions concerning antitrust Law. Moreover, the grantor's interest in order to avoid that the stock can be sold off — with reputational damages and damages concerning competitive positioning of the products — shall be taken into account.

In conclusion, for the grantor it may be more effective to re-purchase all the stock, on condition that such right is contractually provided for, in order to avoid market disruption more damaging also with regard to new dealer's activity and/or grantor's activity, if grantor decide to directly handle the distribution on the area.

Chapter II

TERMINATION OF FRANCHISING AND DISTRIBUTION AGREEMENTS IN AUSTRIA

by *Josef Wolff* (*)

1. Franchising: legal regulation.

Franchising is not regulated by law in Austria. There is no legal definition of the contract. The legal basis for mutual claims is primarily the contract. The Handelsvertretergesetz (Law on Agency 1993 as amended by Federal Law Gazette I No. 29/2016) is applied analogously, in particular with regard to the right to compensation under Article 24 of the Handelsvertretergesetz.

Jurisprudence and doctrine have developed the following definition of a franchise agreement (1):

The franchise agreement establishes a long-term relationship whereby the franchisor grants the franchisee the right to trade certain goods and / or services using the name, trade mark, equipment, etc., as well as the professional and technical experience of the franchisor, respecting the developed organization system and advertising system

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(*) *Lawyer in Austria, Salzburg - JoseF.Wolff@kanzlei.wolff.at*

(1) OGH (Supreme Court) of 05.05.1987, 4 Ob 321/87, Rechtssatz RS0071387 ("Rechtssätze" are guidelines takes from decisions of the Supreme Court. They may be openly consulted on *https://www.ris.bka.gv.at/Jus/*.

whereby the franchisor grants the franchisee assistance, advice and training in technical and marketing terms and exercises control over the business of the franchisee.

In the absence of a legal definition, there are numerous different franchise agreements. The "*service franchise*" is known for the provision of a service, the "*production franchise*" for the production of a product and the "*sales franchise*" for the distribution of the products produced by the franchisor (2).

The franchisee is active in his own name and on his own account and must or may use the franchisee's procurement, sales and organizational concept. Characteristic is the strict organization for each franchise system. The franchisee remains a self-employed entrepreneur who acts in his own name and on his own account.

In contrast to the franchisee, a contractual partner may be

a) "*worker-like*" if the franchisor can influence the investing and financing decisions of the franchisee by means of individual instructions in such a way that any entrepreneurial discretion is taken. The franchisee loses his independence. In this case, the franchisee must pay social insurance contributions. The special provisions for employees (eg employer's liability insurance laws) apply to damages (3).

b) a "*commercial agent*", if he only takes over the mediation of transactions and concludes them in his own name and on his own account.

c) a "*distributor*" if he, although he acts in his own name and for his own account, is not so closely involved in the procurement, sales and organizational concept of the franchisee.

There are no mandatory rules specifically for the franchise contract. The general rules of contractual law apply (in particular the prohibition of unlawful clauses or clauses against good faith, the prohibition of grossly disadvantageous clauses in form sheets, mandatory provisions of consumer protection law, cartel law and industrial property rights).

There are no restrictions on foreigners to form a franchise relationship in Austria or with an Austrian partner. There is no registration requirement.

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(2) Neumayr/Simon, *Austrian and European cartel law aspects of franchise agreements*, OZK 2008, 50.

(3) VwGH of 19.10.2005, 2004/08/0082; OGH 12.11.1979, 4 Ob 68/97.

There are no standards that would require the publication of a franchise relation. There is no statutory regulation on the information a franchisee must give to a franchisor. Such obligations may be provided for by contract. There is case law of the Austrian Supreme Court on the validity of individual clauses.

There are no formal regulations regarding the contract. An oral franchise agreement is also sufficient.

It should be noted, however, that the Law on Agency (Handelsvertretergesetz) and the relevant jurisprudence (in particular the claim to compensation) can be applied analogously to franchise agreements if the contractual position of the contracting parties permits analogous application.

There is no general rule for the analogous application of the Law on Agency. It is always a case-by-case decision. According to the case law of the Supreme Court (the OGH), an analogous application of the Law on Agency is possible, if essential elements of the agency law also exist in the franchise relationship.

These include: the duration of the contract, sales of the franchisee in his own name and for his own account, cases where the franchisee has been granted the exclusive right to sell in a particular district, an agreed non-competition clause, obligatory involvement in a procurement, sales and / or organizational concept, obligation to exclusively sell the products of the franchisor, purchase commitments, franchisor's right to give instructions and to control performance, mandatory rules on pricing and information requirements of the franchisee.

1.1. Network belonging and the appearance principle.

Contrary to the distributor, the franchisee is more involved in the sales concept of the manufacturer/franchisor. This is achieved by:

- uniform marketing;
- transfer of know-how of the franchisor;
- right to give instructions regarding product assortment and pricing;
- use of the franchisor's industrial rights (eg copyrights, patent rights).

The appearance principle is a principle of Italian law and, as such, unknown to Austrian law. It states that the third party acting in good faith, who believes on the basis of the brand and the appearance that he would contract with a branch of the franchisor, is protected in this

assumption. If he suffers any damage, he is entitled to direct claims against the franchisor. This claim comes from the duty of the franchisor to control his franchisee.

Austrian law does not recognize an express claim by a third party against the franchisor. A third party can only claim compensation from the franchisor if the franchise agreement is regarded as a contract with protective effects versus third parties. In this case, the liability arising from the contract also benefits the third party, since the third party is involved in the protection of the contract.

In addition, a contract can also arise directly between the third party and the franchisor: if the franchisor, by his own behavior, makes the appearance that the franchisee acts as the direct representative of the franchisor, then the latter must allow this action to be attributed to himself (appearance) — the contract is directly concluded with the franchisor.

The relationship between the parties to a franchise agreement is dominated by a particularly strong relationship of trust. In the performance of their contractual obligations, the parties have to cooperate with trust and have to take increased consideration for the interests of the other party.

1.2. Economic dependency abuse.

An abuse of the economic power of the franchisee may have implications in antitrust and contractual law.

The franchise agreement may contravene antitrust law ("Kartellrecht"). Franchise is in tension to the freedom of competition. Contracts which unjustly restrict competition may be void. In addition, infringements of competition are punished by the Federal Competition Authority if the competition is distorted or hindered.

Since franchise agreements usually contain pricing rules, it is necessary to examine whether there is a prohibited cartel in the sense of the Austrian Antitrust Law.

Prohibited cartels are "agreements and concerted practices between undertakings with a view to restricting or preventing competition." This is usually done through price agreements, quota agreements and market sharing (see § 1 Antitrust Law).

According to Section 2 of the Austrian Antitrust Law, the prohibition of cartel does not include:

— trivial cartels, i.e. agreements between two directly competing companies which jointly operate less than 10% of the market, or agreements between two non-competing undertakings, each of which controls less than 15% of the market;

— cartels of which consumers share the profit and which serve to improve the production and distribution of goods or which are used to promote technical or economic progress;

— agreements in the field of agricultural production;

— agreements according to the Regulations on Vertical Restraints (in particular Regulation 330/2010).

The EU Regulation on Vertical Restraints 330/2010 creates exceptions to competition law. The positive effects of franchise constructions should develop through such regulations. Within the scope of the regulation, the cartel is not allowed to control more than 30% of the market (4). Outside the regulation, there is the possibility of an individual examination in accordance with Art. 101 (3) EU treaty.

In the case of permitted cartels to improve the production of goods or economic progress, the Federal Competition Authority may impose measures to ensure a minimum level of competition.

Measures which completely determine pricing and therefore undermine competition are entirely against fair trade laws. This is the case, for example, in online trading practice where manufacturers try to influence the competition through price formation rules for online resale or by refusing to supply in the event of breaches of these requirements. In Austria, this has not yet been strengthened by a clear statement of the Supreme Court (5).

There is no lack of competition in setting non-binding price recommendations. Even binding prices may be permitted in the exceptional circumstances of the Regulation on Vertical Restraints, for example, when new products are introduced or when complex customer support systems or short-term low-cost price campaigns are established (6).

It is not yet clear whether manufacturers may prohibit their

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(4) Tresnak/Haubner*, 7. Competition Talk: „Franchise — ein zulässiges Kartell?“*, ÖZK 2013,11.

(5) Kary, *Vertriebssysteme auf dem Prüfstand, Die Presse vom 31.07.2014*, Die Presse 2014/31/03.

(6) Tresnak/Haubner*, 7. Competition Talk: „Franchise — ein zulässiges Kartell?“*, ÖZK 2013,11.

distributors from using online sales platforms such as ebay or amazon. This practice is still lacking the jurisprudence of the ECJ (7).

There is no lack of competition if certain minimum requirements are imposed on contractors, for example, in-store trade with a corresponding assortment. According to experts, it would also be legal if the manufacturer (franchisor) remunerated the consulting service provided by the franchisee in the in-house business against the end customer. The customers perceive the consulting in the specialist shop, but buy the product online (8).

An abuse of economic dependency in a contractual sense is initially regulated by the contractual regulation.

Each franchise agreement includes an obligation of trust, which prohibits the franchisor's actions against the franchisee which are not in good faith. The franchisor must support the franchisee in his or her business and must not compete directly with the same products at lower prices (9). It is a characteristic element of the franchise contract to have a clause of non-competition.

The franchisor has to support his contract partner in his promotion activities and to refrain from anything that could interfere with this activity and its success.

Thus, e.g. the franchisor, who had expressly reserved the parallel operation of mail-order sales in the franchisee's territory, is obliged, in the exercise of this activity, to pay due attention to the interests of his franchise partner. The franchisor infringes this duty of loyalty if he offers the same articles online on more favorable conditions than for the franchisee 's business customers or removes the previous system of paying vouchers issued online in the franchisee' s business so that the franchisee loses contact to his customers. (10)

The franchisor is obligated to make contractual products available for sale according to these fiduciary obligations of the contract. In the case of an infringement, he may be liable to pay compensation against

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(7) *Die Presse vom 03.09.2015, Onlinehandel: Schelte für Ascis,* Die Presse 2015/36/11.

(8) Kary, *Vertriebssysteme auf dem Prüfstand, Die Presse vom 31.07.2014*, Die Presse 2014/31/03.

(9) OGH of 18.06.1991, 4 Ob 42/91, Rechtssatz RS0071375.

(10) OGH 18.6.1991, 4 Ob 4 Ob 42/91.

the franchisee. This is also one of the many legal questions from the VW "Dieselgate" case (11).

It cannot be stated in advance, if there is a clause contrary to good faith and therefore unlawful. The clause is void according to § 879 ABGB (Civil Code), if the contract partner is "grossly disadvantaged". This is the case when, weighing both interests, there is a gross mismatch between the beneficiary of the agreement and the person who is disadvantaged by the clause.

In this light and depending on the contractual arrangement, the following clauses may be examined:

- rights to give exact instructions of resale prices or conditions for resale;
- obligation of non-competition;
- exclusive subscription rights;
- territorial protection;
- prohibition of delivery to certain third parties; etc.

Caution should be exercised in all such clauses. A more thorough examination of admissibility and efficacy is advisable.

1.3. Contract duration.

The franchise agreement is a contract of permanent duration. It can be concluded for a limited period of time or indefinitely. Temporary contracts cannot be terminated ordinarily before the end of the period. An immediate extraordinary termination for a special reason is however possible.

The reason for the extraordinary termination must be so important that, considering the interests of both parties, it is unacceptable for the contractual partner to comply with the agreed period of notice (eg several months' delay in the payment of the franchise fee) (12). In order to answer the question of whether a particular reason exists, the Supreme Court also followed the jurisprudence and evaluation of the Law on Agency (Handelsvertretergesetz) (13). Personal liability is no prerequisite, even objective aspects are sufficient. A termination for important reasons is not justified if the maintenance of the contract is

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(11) Kommenda, *VW-Affaire: Wer kann was von wem verlangen?, Die Presse vom 12.10.2015*, Die Presse 2015/42/01.

(12) OGH of 10.04.1991, 9ObA8/91, Rechtssatz RS0071387.

(13) OGH in 4 Ob 321/87.

only "annoying" to the terminating party, but the continuation of the contract can be expected, taking into account the principle of the faithful performance of the contract.

Subject to the analogous applicability of the Law on Agency (Handelsvertretergesetz), a fixed-term contract is extended indefinitely if the parties continue to collaborate after the end of the term (pursuant to § 20 Handelsvertretergesetz).

Moreover, in § 22 Handelsvertretergesetz, some important reasons for an extraordinary immediate termination are — not exhaustively — listed (these are: incapacity to perform the activity, refusal of activity, assault on franchisor, bankruptcy, mistrust or infringement of essential contractual provisions (payment of commission), assaults, termination of business). According to § 23 Handelsvertretergesetz, the party liable for the premature dissolution must provide compensation to the other party.

A very long contractual relationship with exclusive rights or obligations can, however, be illegal and therefore invalid. A 20-year term has been decided as being an upper limit by the Supreme Court regarding of treaties for sale of beer. However, a longer duration may also be permissible, depending on the investment. This depends on the time the franchisee has paid for his investment and whether he is unlawfully gagged on the basis of the terms of the contract.

1.4. Termination clause and minimum target.

The termination of a franchise contract usually has a serious impact on both parties. Consider the loss of a sales market or whole sales territory in the case of a regional exclusivity or investments by the franchisee or a non-competition clause which restricts the franchisee in his activity after the contract has been terminated. The interests of the parties at the end of the contract are therefore contrary.

The terms of termination shall be governed by the contract. The contract is normally terminated by a unilateral declaration, observing a reasonable period of notice.

Which period of notice is appropriate depends on the contract or commercial usage. Similarly, in the absence of contractual provisions, the periods of notice in § 21 (1) Handelsvertretergesetz may also be used. The law states a period of notice of 4 months after the fourth year of the contract, a period of 5 months after the 5th year, and a 6-month period from the 6th year, respectively, to the calendar month's last.

In analogous application of the Handelsvertretergesetz, a post-negotiated non-competition clause cannot be validly agreed in accordance with § 25 Handelsvertretergesetz. If the Law on Agency cannot be applied analogously, it must be examined whether the clause of a post-contractual non-competition clause is not contrary to § 879 ABGB (Civil Code).

1.5. Contract termination: termination indemnity and / or compensation.

After the contract has been terminated, the franchisee may not carry out any sales activity, must not continue using trademark or design rights of the franchisor and must return the franchisor's operating material.

The franchisor may, after termination of the contract, prohibit the franchisee from using commercially protected rights (copyrights and patent rights) as well as the use of the know-how.

Upon termination of the contract, the franchisee shall be entitled to a compensation in analogous application of § 24 Handelsvertretergesetz as well as a reimbursement of investments pursuant to § 454 UGB (Unternehmergesetzbuch - commercial code):

Compensation claim

A definitive decision as to whether the compensatory claim of the commercial agent is also applicable to the franchisee is not yet available. The case law trend is clearly in this direction. The applicability depends on the analogous approach of the Law on Agency.

In the event of analogous application of the Law on Agency, the compensation claim pursuant to Section 27 para. 1 Handelsvertretergesetz may not be contractually excluded.

The right to compensation is due if the franchisee has introduced new customers and the franchisor can also benefit considerably from these new customers after the contract has been terminated. It is also sufficient if the customers procured by the franchisee have actually passed on to the successor of the franchisee (14). The development of the new customer base should be compensated (15).

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(14) OGH of 30.08.2006, 7 Ob 122/06a.

(15) Commenda, *Franchise-Nehmer erhalten Ablöse, in Die Presse vom 09.10.2006*, Die Presse 2006/41/03.

A formal requirement of the compensation claim is the termination of the contract, for example, by consensual dissolution, termination, death of the franchisee, termination or end of contract period.

The right to compensation is not granted if the franchisee terminates the contract unjustly, has set the grounds for dissolution or has stopped working for the business without terminating the contract. The claim is nevertheless still valid if the franchisee had to terminate the contract because of illness or age or cannot be expected to comply with the contract for reasons which are attributable to the franchisor.

Calculation of the compensation claim

The right to compensation is based on the increase in the value of the franchisor's business which the franchisee has caused. Therefore, the payment of the compensation claim must correspond to equity in view of all the circumstances of the individual case. The calculation therefore includes a loss of future commissions or profits of the franchisee and an investment reimbursement.

The calculation of the compensation claim is scarcely regulated by law. In the absence of a more favorable agreement for the commercial agent, it may not be more than one annual remuneration calculated from the average of the last five years. If the contractual relationship has lasted less than five years, the average calculated from the whole duration of the contract is decisive.

Reimbursement of Investment

In addition to the compensation claim, the franchisee may demand refund of investment upon termination of the contract pursuant to § 454 UGB.

This provision states:

An entrepreneur who participates in a vertical distribution binding system as a bound entrepreneur or an independent commercial agent (§ 1 Handelsvertretergesetz) shall be entitled, upon termination of the contractual relationship with the binding entrepreneur, to have refund of the investments which he was obliged to make under the terms of the distribution agreement for a uniform distribution in so far as they are neither amortized nor appropriately usable at the time the contract is terminated.

The investment reimbursement is due only in the case of a vertical sales condition. This is based on § 30 a Kartellgesetz and refers to bonds between companies at different levels, which restrict the bound

company in the purchase or distribution of goods or services (16). The most important clauses qualified as vertical distribution are: exclusive delivery and purchase obligations, territorial protection and non-competition clauses.

If the franchisee was forced to invest in the uniform appearance and sales concept, he can demand reimbursement of these investments. The prerequisite is that at the end of the contract investments are not yet amortized and cannot be appropriately valued. The reimbursement of investments other than those for the uniform appearance and distribution concept cannot be claimed under this provision. The investments concern, for example, purchase of special tools or the specific training of personnel, but not the purchase of the products or investments to be sold which go beyond the supplier's specifications (17).

The investment reimbursement does not apply if the franchisor terminates the contract for just cause or the franchisee terminates the contract (ordinarily or prematurely without justification). The dissolution is unjustified if there is no reason for the franchisor.

A reimbursement of investments is also payable in the case of consensual termination of the contract and may not be excluded before the termination of the contract. The contracting parties are, however, free in the definition of calculation rules.

The franchisee must assert both the right to compensation and the right to reimbursement of investments within one year after the termination of the contract against the franchisor. Otherwise his claims is not admitted. The filing of an action is not necessary according to the regulation in the Handelsvertretergesetz (§ 24). The claims are subject to a three-year limitation period in which they must be asserted in court.

2. Distributorship — "*Vertragshändlergeschäft*": legal regulation.

Distributorship is not regulated by law. Similar to a franchise

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(16) Petsche*, Investitionsersatzanspruch in vertikalen Vertriebsbindungen, Der neue § 454 UGB*, ecolex 2004, 95; This claim is also admitted for an agent, also if he is not a bound company according to § 30a Kartellgesetz.

(17) OGH of 16.03.2007, 6Ob254/06f.

relationship, the Law on Agency is applied analogously under certain conditions.

The contract is concluded free of all forms. This freedom finds its limits in generally civil law and antitrust regulations.

Judiciary and doctrine have developed the following definition:

The distributor is obliged to distribute the goods of the contract partner in a particular area in his own name and for his own account and to promote the sale as best as possible. He is integrated into the manufacturer's operating system. However, the manufacturer usually only has instructions with regard to the sales system and the customer service (18).

The distributor will not act as agent for the manufacturer. He retains his independence in terms of operational management and corporate risk.

In most cases, regional protection, a minimum quantity of sales and price formation rules are agreed (19).

The jurisprudence is of the opinion that the compensation claim pursuant to § 24 Handelsvertretergesetz is also applicable to distribution agreements if an analogous application of the law is possible (20).

It is decisive whether the contractual relationship can be equated with that of a commercial agent. The analogy is possible with regard to the following contractual characteristics: integration into the distribution network, right of the manufacturer to give binding instructions, non-competition clauses, obligations to inform the distributor, economic dependency and vulnerability of the distributor by means of monetary and commercial credits granted by the manufacturer, obligation to control books and obligation for the distributor the transfer his customer base to the manufacturer at the end of the contract (21). This analogy has been confirmed several times for distributors of motor vehicles (22). The following criteria are indicative of a high integration into the distribution network, but not all criteria must be met (23):

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(18) OGH 4Ob79/95; 6Ob323/98p; 7Ob265/01y; 4Ob141/06y, Rechtssatz RS0090878.

(19) OGH 3Ob608/82; 4Ob141/06y; 4Ob113/15v; Rechtssatz RS0053898.

(20) OGH vom 11.10.1990, 6Ob644/90, Rechtssatz RS0062645; latest: 3 Ob 44/09f.

(21) OGH of 29.11.1989, 1Ob692/89, Rechtssatz RS0062580.

(22) OGH in 1 Ob 359/99x mwN.

(23) Following Rothermel, Dahmen, *Unwirksame Klauseln in Vertriebsverträgen — Versuch einer Katalogisierung,* in IHR 2017, 45.

• distributor obtains exclusivity (such as exclusive distribution, exclusive territory, territorial protection, customer protection, etc.);

• distributor has success requirements (minimum sales);

• distributor is subject to restrictions (competition or non-competition);

• distributor must meet specifications (establishment of business premises, availability of samples);

• distributor must meet quality requirements or provide certain services,

• distributor is subject to inspection and reporting requirements (e.g., customer data);

• distributor provides concerted marketing and advertising.

If these obligations result in an analogous applicability of the Law on Agency (Handelsvertretergesetz), the following provisions are compulsory:

• entitlement to commission (§§ 9 (2) and (3), 12 (1), 14, 15 and 26b (2) and (4), Section 26c (1a) and Article 26d);

• entitlement to review books and have book extracts (§§ 16 para. 1 and 2);

• agreement on shorter periods of notice than required by law are not permitted (§§ 21 para. 1 and 3);

• claims in case of early termination (§ 23);

• compensation claim (§ 24);

• compensation in case of termination by insolvency (section 26 para. 2).

2.1. Exclusivity Clause — "*Alleinvertriebsrecht*" and "*Gebietsschutz*".

An exclusive right of distribution exists if the manufacturer authorizes only one distributor in a given territory. Territorial protection applies where the manufacturer undertakes to restrict distributors to the activities of a territory and to impose restrictions on their districts on distributors in other districts. Whether the right to exclusive distribution covers also a territorial protection depends on the formulation of the contract considering also to the exercise of honest trade ([24]). It is a question for the interpretation of the contract whether

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([24]) OGH of 28.09.2006, 4Ob141/06y, Rechtssatz RS0121281.

the exclusive distribution agreement also entails a protection of the territory or a customer protection in the sense of the fact that customers must be referred to the competent distributor.

By granting an exclusive distribution right, the manufacturer waives the right to distribute the goods in the territory in a different way than by the distributor. The manufacturer must refrain from providing direct deliveries to customers in the protected area ([25]).

By virtue of an exclusive distribution right, the trader cannot enter the monopolistic area of another trader. This behavior to the detriment of the other member of the same sales organization violates rules of trade in good faith in the sense of § 1 Law against unlawful competition (Gesetz gegen den unlauteren Wettbewerb - UWG). The distracted distributor has an injunction against competition ([26]).

In an agency relation all orders placed with the agent converge and are executed by the manufacturer. In a relation of distribution the manufacturer does not have a direct possibility of stopping the supply into a contract territory of one of the distributor authorized by the manufacturer by another distributor, or to involve at least the "authorized" distributor in this business in one form or another. He could do so only indirectly through contractual penal clauses or a right of extraordinary termination.

The risk that his exclusive distribution right for a particular district is undermined by another distributor from outside and without the cooperation of the manufacturer / supplier is in principle borne by the distributor himself.

Also a supplier may compete with his distributor who has the exclusive distribution right for a particular sales territory. If the supplier violates this agreed area distribution, this may result in a breach of competition which is contrary to competition law ([27]).

For some sectors there are specific laws regarding competition. In the motor vehicle sector ([28]), certain distribution agreements were excluded from the prohibition of cartels under the Vertical (motor vehicle) Block Exemption Regulation ([29]). This also applies to the

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([25]) OGH of 11.08.2015, 4Ob113/15v.

([26]) OGH 4Ob362/79; 4Ob349/82; 4Ob402/81; 4Ob2/88; 4Ob323/97x, Rechtsatz RS0079297.

([27]) OGH 3. 4. 1990, RdW 1990, 312 for the case of a franchise relation.

([28]) Haid/Xeniadis, *Paradigmenwechsel für den Kfz-Vertrieb*, ecolex 2010, 638.

([29]) Regulation (EU) Nr. 330/2010.

market for spare parts if the market thresholds of the Regulation 330/2010 on Vertical Restraints are met (30) and no core constraints of Art 4 of the Vertical Restraints Regulation are met (31).

The manufacturers often agree that the distributor is not allowed to resell the products to third-party resellers. A closed distributor network is to be created. "Non-net" salespersons would not be bound by the terms of sale of the manufacturer. The manufacturer cannot usually take legal action against third parties. According to the Supreme Court, the exploitation of a third-party breach of contract is not unfair commercial practice and is therefore permitted under competition law. Only if special circumstances arise, eg the incitement to the breach of contract, the behavior of the net alien is unlawful. Furthermore, the manufacturer has no claim to provide information about the distribution channels as he has to his right according to § 55 Intellectual Property Act (MSChG). This would encourage closure of the market. This closure may be a threat in case of deliveries outside of the distributor's network (32).

2.2. Duration of contracts — Termination clause and minimum target.

The parties are free to determine the duration of the contract. There is no legal provision. Contracts concluded for an indefinite period of time are terminated ordinarily with a period of notice. Temporary contracts end with the expiry of time.

Since the contractual relationship is a permanent contract, it can be dissolved by ordinary or extraordinary termination. An extraordinary termination is possible in the case of a serious breach of contract, the loss of confidence in the person of the partner or serious changes in the circumstances that make it unacceptable (33) for the partner to be compliant with the contract. Reasons that were already foreseeable at

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(30) Shares of market less than 30%.

(31) Especially price regulations of second sales and territorial limitations of customer limitation.

(32) Moritz, *Der „verräterische" Vertragshändler an der Schnittstelle zwischen Marken- und Wettbewerbsrecht*, ÖBl 2016/14.

(33) OGH vom 25.05.2000, 8 Ob 295/99m; OGH vom 11.08.2008, 1 Ob 113/08m.

the time the contract was concluded or changes which were obviously accepted, do not justify premature termination (34).

The right to extraordinary termination also exists in the case the parties agreed on a clause which forbids termination of the contract (e.g. before a definite period of time) or in the case of fixed-term contracts (35).

Regarding termination clauses, the parties have to be careful to observe rules of good faith. Unless otherwise stipulated, termination of the contract is only possible under unacceptable conditions. In the case of such adhesion contracts, the distributor is curtailed in his entrepreneurial freedom (36).

The deadlines for ordinary termination are determined by the agreement. Similarly, the periods of the Law on Agency are applied. The law applies a period of notice of 4 months after the fourth year of the contract, a period of 5 months after the 5th year, and a 6 months period from the 6th year, respectively to the calendar month's last.

A minimum sale can be agreed. The producer may also insist on the agreed minimum sales if the goods are difficult to sell (37).

2.3. Contract termination: termination indemnity and/or compensation.

The distributor may claim compensation if the Law on Agency can be applied by analogy. The right to compensation is payable if, through the activity of the distributor, the manufacturer has grown to new customers who also remain customers. The distributor must have contributed to the increase in the value of the manufacturer.

This right to compensation shall only exist if the increase in the value is greater than the amount already received by the distributor as a trading margin and investment or advertising cost subsidy (38). In the calculation of the compensation claim, the effect of a known brand and the risk of customer migration must be observed within the limits of

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(34) OGH vom 23.11.2000, 6 Ob 59/00w.

(35) OGH vom 27.01.2017, 8 Ob 4/17x; RIS-Justiz RS0027780; RS0018377.

(36) OGH Entscheidungen 3Ob608/82; 7Ob265/01y; 6Ob95/16p, Rechtssatz RS0016793.

(37) Rechtsatz RS0053898.

(38) OGH of 24.11.1998 1 Ob 251/98p.

equity ([39]). The gross domestic product of the last five years applies as a basis for its assessment.

In the context of freedom of contract, it is, of course, possible to agree on a compensation claim in accordance with § 24 Handelsvertretergesetz. If an analogous application is possible, however, an agreement cannot be more disadvantages for the distributor than as provided by law.

Reimbursement of investments

According to § 454 UGB, the manufacturer has to refund investments if he has forced the distributor to make investments which are not yet amortized at the time of the contract and which cannot be appropriately utilized. This is the same legal situation as for the franchisee.

Both compensation claims and entitlement to refund of investment expire if they are not asserted in writing against the manufacturer within one year after the date of termination of the contract. They are also subject to a statutory limitation in any event of three years.

2.4. Stock after termination of the contract: rights and obligations of the parties.

The fate of the goods warehouse after termination is primarily determined by the agreement. The contractual exclusion of any obligation to re-purchase such goods in form sheets (ABGs) may be illegal according to § 879 Abs 3 ABGB and therefore invalid. The clause is unlawful if the contractual partner is "grossly disadvantaged".

This is the case when, weighing both interests, there is a gross mismatch between the beneficiary of the agreement and the person who is disadvantaged by the clause. Such may be if a contracting party tries to enforce his own interests at the expense of the other contracting party by means of a one-sided amendment to the redemption obligation. The exclusion of the obligation to take back products which the distributor had to buy on the basis of the agreement is unlawful. Similarly unlawful would be a provision to exclude a re-purchase if the contract was terminated without the negligence of the distributor ([40]).

([39]) OGH of 09.04.2002, 4Ob54/02y; Rechtssatz RS0116277.

([40]) Knöbl, *Zur Sittenwidrigkeit von Vertragshändler-Verhandelsklauseln-„Leitfunktion" des BHG*, ecolex 2007, 755.

If the manufacturer makes use of the contractually agreed right of termination, an obligation to re-purchase goods may be derived from (post-)contractual obligations of loyalty or claims for damages. The manufacturer must, however, only take back that part of the warehouse which the distributor was obliged to store under the contract. The distributor cannot impose on the manufacturer the risk of miscalculation or overstuffing of inventory (41).

If the manufacturer has terminated the contract prematurely without good cause, he is obliged to take back the products purchased from the distributor for reasons of damages and subsequent contractual liability.

If the distributor has caused the dissolution of the contract, there is no obligation to take back the goods. This would be the case if the manufacturer terminated the contract prematurely, because the distributor has established a behavior that makes the contracting unreasonable.

The risk of the aggravated exploitation of the inventory is the responsibility of the person who committed the contract termination.

3. Conclusion.

Both franchise and distribution relations are not regulated by law in Austria. There is, however, extensive case-law on individual questions (in particular regarding extraordinary termination due to important reasons, the right to compensation and cartel and competition law problems). Special care must be exercised in the design of the contract. In particular, the obligations after termination of the contract are subjected to a strict validity check (illegal or unlawful). The Law on Agency serves as a model and is often used analogously.

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(41) OGH of 16.03.2007, 6Ob254/06f regarding an obligation to re-purchase spare material.

Chapter III

TERMINATION OF FRANCHISING AND DISTRIBUTION AGREEMENTS IN BELGIUM

by *Anna Gibello* (*)

(*) *Lawyer in Belgium, Bruxelles Anna.gibello@flinn.law*

1. Introduction.

Commercial distribution law in Belgium is mostly defined through three applicable laws:

— the Law of 27 July 1961 with respect to the unilateral termination of indefinite term exclusive distribution agreements;

— the Law of 13 April 1995 with respect to commercial agency agreements;

— the Law of 19 December 2005 on pre-contractual information in connection with commercial partnership agreements.

When it was in the process of codifying its economic laws, the Belgian Legislator pondered the necessity of aligning franchise and distribution agreements within the more structured framework of that applicable to commercial agency, which, inspired by EU Directive 86/653 on the coordination of laws of Member States relating to self-employed commercial agents, settles the formation, performance and termination of agency agreements.

In the end, the idea of reform was abandoned and these laws were repealed and inserted (mostly without change) into Book X of the Code of Economic Law (the "CEL") by the Law of 2 April 2014 concerning the insertion of Book X "*Commercial Agency Agreements, Commercial Cooperation Agreements and Distribution Agreements*" in the CEL and integrating any specific definitions required into Book I of the CEL (the "Law of 2 April 2014") (1). By Royal Decree dated 4 April 2014, the date of entry into force of Book X of the CEL was set to 31 May 2014 (2).

In this presentation, which we do not claim exhaustive, we begin with a brief introduction to the legislation concerning the pre-contractual information requirements for commercial partnership agreements (Articles X. 26-34 of the CEL), followed by an overview of the Belgian rules with respect to termination of exclusive distribution agreements (Articles X. 35-40 of the CEL), as well as certain aspects relating to the termination of franchise agreements, although this is not covered by specific legislation.

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(1) *M.B.*, 24 April 2014, p. 35053.

(2) Royal Decree of 2 April 2014 concerning the insertion of Book X "Commercial Agency Agreements, Commercial Cooperation Agreements and Distribution Agreements" into the Code of Economic Law and integrating any definitions specific to Book X into Book I of the Code of Economic Law, *M. B.*, 28 April 2014.

2. Pre-contractual Information in Belgium and Commercial Partnership Agreements.

2.1. Objectives of the Legislation.

In adopting the Law of 19 December 2005 on pre-contractual information in connection with commercial partnership agreements (3), the Belgian Legislator intended to counter the abuses which had appeared within certain commercial distribution networks where adhesion contracts were often used. The objective was to re-establish the balance in favour of the apparently weaker party, by requiring any initiator of a commercial partnership formula to undertake a series of obligations in the pre-contractual phase.

Thusly, the Law of 19 December 2005 on pre-contractual information in connection with commercial partnership agreements, as part of the movement begun in France (4), Spain (5) and Italy (6), introduced into the Belgian legal system the obligation to provide specific information prior to the conclusion of such agreements.

As mentioned above, when the economic laws were codified, the Legislator incorporated the provisions of the Law of 19 December 2005 into Title 2 of Book X of the CEL with several improvements (7).

We will limit ourselves to outlining, in broad strokes, the obligations contained in Title 2 of Book X of the CEL, without commenting on the nature of the changes made at the time of codification.

2.2. Scope.

Although the Law of 19 December 2005 was often referred to as the 'Franchise Law', the Legislator did not intend to limit the scope of the law to one or more types of agreement in particular, but instead,

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(3) *M.B.*, 18 January 2006, p. 2732.

(4) Law of 13 December 1989, called Doubin Law, inserted in the Code of Commerce under art. L 330-3 and its implementing decree of 4 April 1991, inserted into the Code of Commerce under art. L 330-1.

(5) Law of 15 January 1996 and its implementing Decree of 13 November 1998.

(6) Law of 6 May 2004, supplemented by the Ministerial Decree of 2 September 2005, n. 204.

(7) "*(...) in order to ensure* (the Law of 19 December 2005) *greater legal efficiency, while striving to adapt to the reality of economic life and simplify its application as much as possible*", *Doc. parl.*, Ch. Repr., No. 53-3280 / 001, p. 5.

wanted to ensure a very wide scope by introducing *ex novo* the contractual category of commercial partnerships.

Henceforth the commercial partnership is defined in Article I.11, 2° of Book I of the CEL, as any "*agreement between several persons, whereby one of these grants another the right to use one or more of the following commercial formulas for the sale of products or provision of services: a common brand, a common trade name, transfer of know-how, commercial or technical assistance*" (8).

Accordingly, a commercial partnership agreement requires:

— a contractual relationship is established among several persons;

— one of these persons grants a right to use a commercial formula which comprises a common brand *or* a common trade name, *or* the transfer of know-how *or* commercial or technical assistance; and

— the commercial formula involves the sale of products or the provision of services.

As for the possible incarnations of such commercial formulae, the Legislator has set out four possible forms:

a) Common Store Brand

This form of commercial partnership consists in the sharing of a store brand, i.e. the distinguishing element identifying a common commercial business enterprise, generally placed upon a building's facade.

b) Common Trade Name

This is the name under which the business operates and is used to identify the business, as opposed to the name that is used to identify the company or the brand that aims to distinguish the products or services of a company (9).

As is the case for the store brand, for the law to apply, it is necessary that the trade name be common to both the person who grants the right to use and the one receiving such right.

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(8) Art. I, 11.2° of the CEL, inserted by art. 2 of the Law of 2 April 2014 concerning insertion of Book X "*Commercial Agency Agreements, Commercial Cooperation Agreements and Sales Concessions Agreements*" in the Code of Economic Law and integrating any specific definitions required into Book I of the Code of Economic Law.

(9) P. Demolin, *L'information précontractuelle et la commission d'arbitrage. Commentaires de la loi du 2 avril 2014 portant insertion du Titre 2 du Livre X du Code de droit économique*, *Les Dossiers du Journal des tribunaux*, n. 95, Larcier, 2014, p. 42.

c) Know-How

Article 1(1)(g) of Regulation (EU) n. 330/2010 of the Commission of 20 April 2010 on the application of Article 101, 3 of the TFEU to categories of vertical agreements and concerted practices defines know-how as "*a package of non-patented practical information, resulting from experience and testing by the supplier, which is secret, substantial and identified: in this context, 'secret' means that the know-how is not generally known or easily accessible; 'substantial' means that the know-how is significant and useful to the buyer for the use, sale or resale of the contract goods or services; 'identified' means that the know-how is described in a sufficiently comprehensive manner so as to make it possible to verify that it fulfils the criteria of secrecy and substantiality*" (10).

The transfer of expertise is mostly present in franchise agreements and usually results in the delivery to the franchisee of an operating manual that includes the franchisor's know-how.

d) Commercial or Technical Assistance

Although technical and commercial assistance are not specifically defined, the preparatory work for the drafting of the Law of 19 December 2005 refers to the benefits "*of logistical support and the expertise and advice from large distribution groups*" (11).

Commercial or technical assistance imply intensity and continuity. These elements must be present from the start of the commercial partnership (market research, point of sale location, etc.) and remain present throughout the commercial relationship (staff training, development of the distribution network, promotional activities, etc.) (12).

It must be pointed out that the intention of the Belgian Legislator was to encompass the most forms of commercial cooperation possible, so that Articles X.26 and following of the CEL do not only apply to franchise agreements, which are naturally included within the scope of the CEL as their main feature is the transfer of know-how, but also to other forms of agreements as long as at least one of the conditions contained in the definition of a commercial partnership agreement applies. For example, this is the case for license, distribution, commercial agency and association agreements. Nevertheless, it goes without

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(10) See also Regulation (CE) n. 772/2004 on the application of art. 81, § 3 of the Treaty to categories of technology transfer agreements.

(11) *Doc. parl.*, Ch. repr., n° 51-1687.005, p. 4.

(12) P. Kileste, C. Staudt, *Contrat de Franchise*, *Répertoire Pratique du Droit Belge*, Bruylant, 2014, p. 68; P. Demolin, *op. cit.*, p. 43.

saying that regardless the title an agreement may have been given by the parties, applicable law will be determined on a case-by-case basis taking into account the characteristics and specificities of the agreement.

2.3. Pre-contractual Obligations under Title 2 of Book X of the CEL.

Article X.27 of the CEL (13) provides for the following obligations with respect to pre-contractual information:

a) communication, in writing or on a durable and accessible medium (i.e. a file on CD or USB key) (14), of the proposed draft agreement and a pre-contractual information document ("PID") (15)

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(13) Art. X. 27 of the CEL: "*Subject to the application of Article X.29, the person who grants the right provides the other person, at least one month before the conclusion of the Trade Partnership Agreement referred to in Article I.11, 2, the draft agreement and a special document containing the data referred to in Article X.28. The draft agreement and this pre-contractual document are made available in writing or on a durable and accessible medium to the person receiving the right.*

If, after the communication of the draft agreement and the pre-contractual information document, any data required under Article X.28, 1, 1°, is changed in these documents, unless the change is requested in writing by the person who receives the right, then the grantor must provide to the other person, at least one month before the conclusion of the commercial partnership agreement referred to in Article I.11,2°, the modified draft agreement and a simplified pre-contractual information document. This simplified pre-contractual information document must contain at least the major contractual provisions required under Article X.28,1,1°, which have been modified.

Subject to the application of Article X.29, and except for obligations under a confidentiality agreement, no further obligation can be undertaken, no other remuneration, fee or deposit may be requested or paid before the expiry of the one-month period under this Article".

(14) Comm. Charleroi, 16 January 2009, *D.A.O.R.,* 2014, liv. 111, p. 81.

(15) Art. X. 28 of the CEL: "*The pre-contractual information document referred to in Article X.27 comprises two parts which must include the following data:*

1° Important contractual provisions, provided that they are to be included in the commercial partnership agreement:

a) a statement s to whether the commercial partnership agreement is concluded in consideration of the person involved;

b) the obligations;

c) the consequences of non-fulfillment of the obligations;

d) the direct compensation to be paid by the person receiving the right to the grantor and the method of calculation of any indirect compensation that the grantor will receive and, where applicable, how they may change during the contract period as well as for its renewal;

e) non-competition covenants, their duration and conditions;

comprising (*i*) a legal section that includes the important articles of the agreement (provided they are to be included in the commercial partnership agreement) and (*ii*) a section that includes socio-economic data to allow informed consent to the agreement to be concluded with the partner;

b) a waiting period of one month between the communication of the draft agreement and the PID and the signature of the agreement;

c) moreover, the law states that no obligation may be undertaken during this one-month period except for obligations undertaken under a confidentiality agreement;

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f) the duration of the commercial partnership agreement and the conditions for its renewal;

g) the terms of notice and termination of the agreement, particularly with respect to expenses and investments;

h) the right of first refusal or the purchase option in favor of the person who grants the right and the valuation rules upon the exercise of this right or option;

i) the exclusivities reserved for the person who grants the right.

2. Data for the correct assessment of the commercial partnership agreement:

a) the name or the business name and contact information of the person granting the rights;

b) if the right is granted by a legal person, the identity and capacity of the individual acting on its behalf;

c) the nature of the activities of the person granting the right;

d) the intellectual property rights the use of which are being granted;

e) as the case may be, the financial statements for the last three years of the grantor;

f) the commercial partnership experience of grantor and experience in the operation of the commercial formula outside a commercial partnership agreement;

g) the history, status and outlook of the market where the activities take place, general and local perspective;

h) the history, status and outlook of the market share of the network, general and local perspective;

i) as the case may be, for each of the last three years, the number of operators part of the Belgian and international networks as well as network expansion prospects;

j) as the case may be, for each of the last three years, the number of commercial partnership agreements entered into, the number of commercial partnership agreements terminated by grantor, terminated by person receiving the rights and the number of agreements which were not renewed at the end of their term;

k) the expenses and investments the person receiving the right undertakes to honour at the beginning and during the commercial partnership agreement period, specifying the amount and their destination as well as their amortization period, the specific time when they are engaged and their fate at the end of the agreement.

The King may determine the form of the pre-contractual information document referred to in paragraph 1. He may also complement or refine the list of data included in paragraph 1, 1° and 2°".

d) if, during negotiations and after submission of the draft agreement and the PID, changes to the agreement are made, then (*i*) a modified draft agreement and simplified PID that includes at least the important articles of the agreement which were modified and (*ii*) a new waiting period of one month must be respected between the communication of these changes and the signature of the agreement (16).

The burden of proof as to communication of the draft agreement and the PID rests upon the shoulders of the grantor (17). The law is imperative (18) so that the parties may not circumvent or derogate from it amicably (19) (see *infra*). The validity of a standard clause inserted in the agreement may be insufficient in case of a dispute (20), so one cannot understate the importance of collecting and maintaining proof

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(16) The law also provides for communicating a simplified PID for the renewal of fixed term commercial partnership agreements and for the conclusion of a new agreements between the same parties (Art. X.29 of the CEL: "*In cases of renewal of a fixed term commercial partnership agreement, in cases of conclusion of a new commercial partnership agreement between the same parties or in cases of modification of a commercial partnership agreement which has been in effect for at least two years, the grantor must provide to the person receiving the rights, at least one month before the renewal or conclusion of a new agreement or the modification of the commercial partnership agreement under Article I.11,2º, a draft agreement and a simplified document. This simplified document must include at least the following: 1º the important contractual provisions, as provided by Article X.28,1, 1°, which have been modified from the original document, or, if there is no original document, then from the date of conclusion of the original agreement; 2º Data for the correct assessment of the commercial partnership agreement, as provided by Article X.28,1,2°, which have been modified from the original document or, if there is no original document, from the date of conclusion of the original agreement. Notwithstanding paragraph 1, in case of modification of a commercial partnership agreement that has been in effect for at least two years, at the written request of the party receiving the rights, no draft agreement nor simplified document must be provided by the grantor. Article X.27, 3 does not apply to obligations relating to agreements which are in effect when the renewal, the new agreement or the modification of the agreement are being negotiated*").

(17) Anvers, 15 June 2015, *D.A.O.R.*, 2016, liv. 117, p. 31.

(18) Art. X. 26 of the CEL provides that: "*The provisions of this title shall apply to all commercial partnership agreements as defined in Article I.11,2°, notwithstanding any contractual clause to the contrary*".

(19) The person receiving the right may waive the benefit of the law only after the signature of the agreement, provided it follows the requirements mentioned in Art. X. 30, al. 4 of the CEL (v. *infra*).

(20) To this effect, see Liège, 10 February 2015, *D.A.O.R.*, 2015, liv. 115, p. 74; Comm. Charleroi, 16 January 2009, *D.A.O.R.*, 2014, liv. 111, p. 81.

of compliance with these obligations of pre-contractual information (21).

2.4. Sanctions.

The Legislator introduced a series of sanctions to protect the recipient of the rights, more specifically (22):

a) *an action to nullify the agreement*, which is prescribed after two years following the conclusion (or modification) of the agreement, in the following cases:

— failure to provide the draft agreement and PID;

— breach of the one-month waiting period;

— obligation imposed, compensation requested or paid before the expiry of the one-month waiting period, except for obligations under a confidentiality agreement.

The jurisprudence has determined that the performance of the agreement by a party should not be considered a tacit confirmation of the agreement or the waiver of a right or the proof of abuse of rights if such a party later wishes to invoke the nullity of the agreement (23).

b) *an action for nullity of the 'important' clause of the agreement* that would not have been included in the legal section of the PID.

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(21) P. Demolin, *op. cit.,* p. 58.

(22) Art. X. 30 of the CEL: "*In cases of non-compliance with the provisions of Article X.27 and X.29 Article, paragraph 1, the person who receives the rights may invoke the nullity of the commercial partnership agreement within two years its conclusion.*

When the pre-contractual information document does not include the data referred to in Article X.28,1,1°, and Article X.29, 2, the person who receives the rights may invoke the nullity of such provisions in the commercial partnership agreement.

If one of the data referred to in Article X.28,1, 2°, and Article X.29, 2, 2° is missing, incomplete or inaccurate in the pre-contractual information document, or if one of the pre-contractual information document's data required under Article X.28, 1, 1°, and Article X.29, 2, 1° is incomplete or inaccurate, the person who receives the rights may invoke the principles of defect in consent or quasi-delictual fault without prejudice its recourse to the provisions of the preceding paragraph.

The person receiving the rights may validly waive the right to nullify the agreement, or any provision thereof, only after a period of one month following the conclusion of the agreement. This waiver must specifically mention the causes of the nullity which are being waived".

(23) Anvers, 15 June 2015, *D.A.O.R.*, 2016, liv. 117, p. 31.

This nullity is not subject to any specific delay to be invoked but falls under the general period of prescription of 10 years (24).

c) *an action for nullity invoking the general legal principles of defect in consent or quasi-delictual fault* (*i*) if some data for the correct assessment of the agreement (socio-economic data) is missing, incomplete or inaccurate or (*ii*) if any provision of the agreement included in the PID is incomplete or inaccurate.

Noteworthy is the fact that the last paragraph of Article X.30 of the CEL (introduced at codification) makes it possible to waive the right to invoke the nullity of the agreement or of a clause thereof, but only *after* the one-month period following the execution of the agreement and if the causes of nullity being renounced are clearly stated.

2.5. Overriding Mandatory Provisions.

The provisions of Title 2 of Book X of the CEL are mandatory (25). As stated above, they may only be waived after the occurrence of the event against which they offer protection and following the proper formalities of Article X.30, par. 3 of the CEL.

Article X.33 of the CEL provides that the "*pre-contractual phase of the commercial partnership agreement is governed by Belgian law and is of the jurisdiction of the Belgian courts when the person being granted the right to do business undertakes such business activities principally in Belgium*".

Many authors (26) argue that as in commercial agency (Art. X.25 CEL) and for unilateral termination of exclusive distribution agreements entered into for an indefinite period (art. X.39 CEL), the provisions Title 2 of Book X of the CEL concerning pre-contractual information requirements should be considered by the judges (Belgian

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(24) Art. 1304 of the Civil Code: "*In all cases where the action in nullity or rescission of an agreement is not limited to a shorter period by a specific law, then that period shall be ten years to exercise such action*".

(25) Art. X. 26,1 of the CEL: "*Notwithstanding any contractual clause to the contrary, the provisions of this Title shall apply to commercial partnership agreements as defined in Art. I.11,2°*".

(26) F. Rigaux and M Fallon, *Droit international privé*, vol. II, *Droit positif belge*, 2nd Ed., Brussels, Larcier, 1993, p. 565; A. Nuyts, *L'application des lois de police dans l'espace*, *R.C.D.I.P.*, 1999, pp. 31 *et seq*.

and foreign) as mandatory rules and therefore immediately applicable regardless which is the law applicable to the PID or the agreement (27).

The doctrine (28) is presently divided as to the possible impact of the ECJ *Unamar* decision of 17 October 2013 (29) on the overriding mandatory characteristic of Title 2 of Book X of the CEL.

As we await the evolution of case law, **t**he radical penalty provided by law for non-compliance with the pre-contractual information requirements should lead to great caution, especially in international commercial partnership agreements. It is therefore necessary to analyse whether the agreement envisaged falls within the scope of the law and if so, to ensure that the pre-contractual information documents conform to the CEL, both in substance as well as with respect to the specified delays.

3. Distribution Agreements.

3.1. Definition of Distribution Agreement.

Article I.11, 3° of the CEL defines the distribution agreement as "*any agreement under which a person grants, to one or more others, the right to sell in their own name and for their own account, products manufactured or distributed by the grantor*".

A distribution agreement is a bilateral agreement which implies the existence between the parties of a framework agreement (30), which differs from simple purchase and sales transactions — as numerous and

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(27) For a more detailed analysis, see *infra* Section 3.6 and mostly P. Demolin, *op. cit.*, p. 79 *et seq.*; P. Kileste and C. Staudt, *Contrat de franchise*, *Répertoire Pratique du Droit Belge*, Bruylant, 2014, p. 131 *et seq.*

(28) P. Hollander, *L'arrêt Unamar de la cour de justice: une bombe atomique sur le droit belge de la distribution commerciale*, *J.T.*, 2014, p. 297; P. Hollander, *Conflits de lois et de juridictions et questions touchant à l'arbitrage en matière de contrats de distribution commerciale*, in *Regards croisés sur la distribution: concession, agence et franchise*, Larcier, 2015, p. 160; C. Staudt and P. Kileste, *Jurisprudence récente relative aux règles de droit international privé applicables aux contrats de distribution: arrêts Corman-Collins et Unamar*, *J.L.M.B.*, 2015, liv. 9, p. 402 *et seq.*

(29) E.J.C., *Unamar c. Navigation Maritime Bulgare,* 17 October 2013, C-184/12; also *J.T.*, 2014, p. 302.

(30) Cass. 22 December 2005, *Pas.*, 2005, I, p. 2587, R.W., 2007-2008, p. 780; Gand, 5 February 2007, *T.G.R.*, 2008, liv. 2, p. 134; Comm. Anvers, 23 November 2016, *D.A.O.R.,* 2017/1, p. 131.

repetitive may they be (31) — and pursuant to which a supplier agrees to supply to the distributor and in return, the distributor undertakes to promote the sales of products of the supplier and to provide a sales organization for such purposes (32).

A distribution agreement requires a collaborative, structured and permanent organization (33). 'Special rights' must have been granted to the distributor (34); the parties must have given 'specific consents' and agreed to 'specific obligations' imposed upon a party, such as the realization of investments, maintaining inventory, the provision of after-sales services, participation in training and advertising costs (35). It is, however, not necessary that exclusivity be granted to a single distributor, although in practice most distribution agreements provide for such exclusivity (36).

3.2. Form and Proof of a Distribution Agreement.

The distribution agreement is not subject to any specific formality and can therefore be concluded orally.

Absent a written agreement, the proof of the existence of a distribution agreement may be established by any means such as the manner it was executed or the exchanged correspondence, i.e. by *facta concludentia* (37).

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(31) Bruxelles, 22 November 2001, *J.T.,* 2002, p. 242; Comm. Mons, 13 November 2003, *D.A.O.R.*, 2003, p.40; Bruxelles, 9 September 2013, R.A.B.G., 2016, liv. 8-9, p. 559. A distribution agreement must be distinguished from the purchases and sales that result therefrom, notably by the general terms of sales which do not necessarily apply to the distribution agreement (See Comm. Bruxelles, 7 April 2000, *D.A.O.R.,* 2001, p. 164).

(32) Gand, 5 February 2007, *T.G.R.*, 2008, liv. 2, p. 134.

(33) Liège, 14 February 2005, *J.L.M.B.*, 2005, p. 1471; Liège, 27 April 2006, *R.D.C.,* 2007, p. 182; Bruxelles, 14 September 2010, *D.A.O.R.*, 2011, liv. 97, p. 110.

(34) Bruxelles, 2 September 2005*, R.D.C.,* 2007, p. 999; Bruxelles, 17 November 2005, *R.D.C.*, 2007, 1007.

(35) J.F. Fierens and A. Mottet Haugaard, *Chronique de jurisprudence — La loi du 27 juillet 1961 relative à la résiliation unilatérale des concessions de vente exclusive à durée indéterminée (1997-2007)*, *Journal des Tribunaux,* Larcier, 2008, p. 9; Gand, 14 November 2005, *Revue@dipr.be*, 2006, liv. 4, 60; Bruxelles, 9 September 2013, *R.A.B.G.*, 2016, liv. 8-9, p. 559.

(36) Cass. 28 February 2008, *Pas.*, 2008, liv. 2, p. 571, *R.W.,* 2008-09, liv. 18, p. 751; Gand, 3 November 2008, *J.T.*, 2009, p. 502, note G. Sorreaux; Bruxelles, 9 September 2013, *R.A.B.G.*, 2016, liv. 8-9, p. 559.

(37) Comm. Liège, 16 April 2004, *D.A.O.R.*, 2004, p. 33; Gand, 5 February 2007, *T.G.R.*, 2008, liv. 2, p.134; Gand, 13 June 2007, *T.G.R.,* 2008, liv. 2, p. 132;

Among the elements the courts have considered to determine the existence of a distribution agreement, we find: (*i*) the use of the qualification of 'distributor' in advertising, (*ii*) the obligation to purchase products from the supplier, (*iii*) concertation to establish a common sales strategy or sales policies defined by the supplier, (*iv*) the realisation of investments ([38]).

3.3. The Provisions of Title 3 of Book X CEL (f/k/a Law of 27 July 1961).

3.3.1. General Context.

In Belgium, distribution agreements are partially regulated by Title 3 "*Unilateral termination of exclusive distribution agreements entered into for an indefinite period of time*" of Book X of the CEL (Articles 35 *et seq*.), which incorporate the Law of 27 July 1961 relating to the unilateral termination of exclusive distribution agreements entered into for an indefinite period of time, as amended by the Law of 13 April 1971 (the '1961 Law').

The 1961 Law was promulgated in the post-war era, in a time of rapid growth of international commerce, in order to protect Belgian distributors, considered the weaker party, in cases of unilateral termination by the (often foreigner) supplier of distribution agreements of indefinite term.

This legislation is specific to Belgium and is unanimously considered as very protective of distributor rights. No other European countries have adopted similar measures.

3.3.2. Scope.

Articles X.35 *et seq*. of the CEL do not regulate the overall

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Gand, 3 November 2008, *J.T.,* 2009, p. 502; Bruxelles, 14 September 2010, *D.A.O.R.*, 2011, liv. 97, p. 110; Bruxelles, 28 February 2013, *R.A.B.G.*, 2016, liv. 8-9, p. 569; Liège, 24 November 2014*, J.L.M.B.*, 2017, liv. 19, p. 909.

([38]) For additional elements, see J.F. Fierens and A. Mottet Haugaard, *op. cit*., p. 13 *et seq.*; P. Kileste, P. Hollander, *Examen de Jurisprudence. La loi du 27 juillet 1961 relative à la résiliation unilatérale des concessions de vente exclusive à durée indéterminée (July 2002 - December 2008)*, *R.D.C.,* 2009, p. 194 *et seq.*

contractual relationship (39), but rather limit themselves to defining specific aspects pertaining to the termination of the agreement.

Their scope is quite limited, as in fact Article X.35 of the CEL states: "*Notwithstanding any provision to the contrary, the present Title shall apply to*:

1. *exclusive distribution agreements;*

2. *distribution agreements for the sale by the distributor within its territory of most of the products covered by the agreement;*

3. *distribution agreements imposing such important obligations upon the distributor, the burden of which are so great, that termination of the agreement would cause the distributor a grave prejudice*".

Any other distribution agreements not included within the scope of Article X.35 of the CEL remain governed by the common law applicable to obligations.

Since there are various aspects to *exclusivity*, the jurisprudence often approaches exclusivity in terms of market segmentation. Exclusivity, may be (and often is) related to a specific geographic area, but it may also apply to determined market segments (warehouse stores vs small retail businesses, etc.), or specific lines of products manufactured by the supplier (40). One can find situations wherein the distributor has been granted exclusivity for certain products but where the supplier has maintained its right to offer other products for sale in the exclusive territory of the distributor or whereby the supplier has retained rights to sell products, including those for which exclusivity has been granted, to specific customers (41).

For a distribution agreement to be exclusive, it remains required that this exclusivity had been conventionally agreed between the parties. In the absence of a written agreement or an express exclusivity clause, the proof that the benefit of exclusivity has been granted by the supplier must be sought through the intent of the parties by examining, among others, the manner in which the agreement was performed (42).

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(39) Title 2 « *Pre-contractual information concerning commercial partnership agreements* » of Book X of the CEL will apply with respect to the pre-contractual phase of distribution agreements that are within its scope (see *supra*, Section 2).

(40) For a more detailed analysis, see P. Kileste, P. Hollander, *op. cit.*, p. 199 *et seq.*

(41) M. Wagemans, *Concession de vente, Répertoire Pratique du Droit Belge*, Bruylant, 2014, p. 31.

(42) Brussels, 17 November 2005, *R.D.C.,* 2007, p. 1007 and Brussels, 30 January 2004, *R.D.C.,* 2007, p. 965.

As for the concept of *quasi-exclusivity*, this represents situations whereby a distributor, without having been formally granted exclusivity rights, makes the most substantial part of the sales within a territory. The court has wide discretion in determining whether the situation at hand constitutes a quasi-exclusivity.

With respect to the concept of *important obligations*, it has been stated that these do not refer to those obligations which come naturally with the status of a distributor, nor those that a distributor would assume spontaneously to better promote its sales of the licensed products (43).Instead, the jurisprudence targets those obligations imposed upon a distributor by the supplier (44), such as requiring particular premises or equipment, hiring of qualified personnel, assuming warranty obligations or after-sales services, etc.

3.4. Termination of Distribution Agreements of Indefinite Term.

3.4.1. Introduction.

Whilst the CEL deals with the unilateral termination of distribution agreements entered into for an indefinite term, it does not address termination by reason of a fault or defect in its performance (45).

Article X.36 of the CEL states that "*distribution agreements entered into for an indefinite term, except in cases of serious breach of its obligations by a party, can only be terminated following reasonable notice or equivalent compensation to be determined by the parties at the time the agreement is repudiated*".

Before going into more details on the scope of Article X.36 of the CEL, we will review the classic causes of termination of obligations such as immediate termination for serious fault, judicial resolution, the application of a specific resolutory condition (whether based upon a fault or not).

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(43) Brussels, 8 February 2001, *R.D.C.*, 2003, p. 500; Comm. Liège, 11 April 2003, *D.A.O.R.*, 2003, p. 408.

(44) Comm. Mons, 13 November 2003, *D.A.O.R.* 2003, p. 40.

(45) Cass., 22 October 1993, *Pas.*, 1993, I, p. 849; Bruxelles, 22 May 1995, *Pas.*, 1995, II, p. 25.

3.4.2. Termination for Serious Fault.

3.4.2.1. Serious Fault.

A distribution agreement may be immediately terminated upon one of the parties' committing a serious fault.

Jurisprudence has consistently found that a serious fault is one that renders impossible the continued collaboration between the parties which is necessary for the performance of the agreement (46).

Most jurisprudence has held that the notion of serious fault is inconsistent with that of reasonable notice, as the latter implies a continued contractual relationship (47). Nevertheless, a few cases (48) as well as some doctrine, contemplate the continuation of the contractual relationship for a short period of time in order to minimize the damages of the aggrieved party.

A party who wishes to terminate an agreement for serious fault must give notice of the reasons therefor at the latest when the agreement is terminated (49).

Examples of situations where case law has held as justified termination by supplier for serious cause include: (*i*) no response from distributor following a demand letter from supplier to take concrete measures to redress sales which had been falling over several months (50), (*ii*) bypassing a clause prohibiting the transfer of the agreement since it was entered into *intuitu personae* (51) and (*iii*) regular and repeated default of payment of invoices issued by the supplier (52), etc.

As for termination by the distributor, the following were recog-

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(46) Liège, 15 June 2006, *R.D.C.*, 2007, liv. 10, p. 1015; Gand, 5 November 2007, *N.j.W.,* 2008, p. 500; Comm. Tongres, 15 November 2011, *Limb. Rechtsl.*, 2015, liv. 1, p. 50.

(47) Bruxelles, 27 September 2005, *R.D.C.,* 2007, liv. 10, p. 1002.

(48) J.F. Fierens and A. Mottet Haugaard, *op. cit.*, p. 38; Liège, 18 December 2003, *R.D.C.,* 2005, p. 50; Liège, 23 November 2004, *R.D.C.*, 2005, p. 962.

(49) M. Wagemans, *op. cit.*, p. 59; P. Kileste, *La concession de vente, Le droit de la distribution*, Anthemis, 2009, p. 43; Liège, 18 December 2003, *R.D.C.,* 2005, p. 50; Bruxelles, 25 March 2005, *R.D.C.*, 2007, p. 985.

(50) Comm. Bruxelles, 20 December 2006, unedited, cited by par J.F. Fierens and A. Mottet Haugaard, *op. cit.*, p. 41.

(51) Comm. Hasselt, 21 February 1995, *R.D.C.,* 1997, p. 389.

(52) Gand, 5 November 2007, *N.j.W.,* 2008, p. 500.

nized as legitimate causes for termination: (*i*) the violation of exclusivity granted by making direct sales in the territory (53), (*ii*) the unilateral cancellation of a product line without compensation nor repurchase of inventory (54), and (*iii*) the unilateral modification of the territory as described in the agreement (55).

The victim of the serious fault may make a claim for damages under the general principles of liability. However, when the termination is not considered legitimate, the court will award the termination indemnities of Title 3 of Book X of the CEL (56) (see *infra*, Section 3.4.3).

3.4.2.2. Judicial Resolution.

In circumstances where there is a fault of a party in the performance of its obligations, but such that this does not immediately render impossible the continued contractual relationship between the parties, then the aggrieved party may institute proceedings under Article 1184 of the Civil Code for termination of the agreement (57).

Any fault invoked as a basis for action under Article 1184 of the Civil Code does not necessarily lead to the termination of the agreement. The court may grant the defaulting party a delay to fully satisfy its obligations. For the court to declare the resolution of the agreement (*ex tunc*, with effect from its conclusion), a simple default is not enough; such default must be judged as "sufficiently serious" (58).

The prevailing party that has been granted resolution of the agreement by the court may make a claim for the entire prejudice

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(53) Bruxelles, 23 September 1999, *D.A.O.R.*, 2000, p. 55; rejected for reason that the concessionnaire did not protest *in tempore non suspecto*.

(54) Comm. Bruxelles, 5 June 2001, unedited, cited by J.F. Fierens and A. Mottet Haugaard, *op. cit*., p. 42; rejected because the fault had been known for a long period of time.

(55) Comm. Bruxelles, 29 April 1994, *R.D.C.,* 1995, p. 515; granted.

(56) Liège, 18 December 2003, *R.D.C.,* 2005, p. 50.

(57) Article 1184 of the Civil Code: "*Should one of the parties not satisfy its obligations, the resolutory condition is always implied in bilateral agreements.*

In such cases, the agreement is not terminated de jure. The aggrieved party may choose to have the defaulting party fully execute its obligations or request termination of the agreement with damageserest.

Termination must be sought in justice before the courts and they may grant the defendant a delay depending upon to the circumstances".

(58) Bruxelles, 23 March 2005, *R.D.C.*, 2007, p. 985.

suffered by reason of such default, as well as damages under the general principles of applicable law (59).

3.4.2.3. Specific Resolutory Clauses.

Case law has held that the provisions of Title 3 of Book X of the CEL do not preclude the inclusion of a specific resolutory clause in a distribution agreement (60).

There are two categories of specific resolutory clauses: one based upon the fault of a party and the other based upon the simple occurrence of an event without any consideration given to the notion of fault (61). They allow for immediate termination, without notice or compensation, and without the intervention of a judge.

Examples of resolutory clauses based upon a fault confirmed by the courts as justified for termination of the agreement include (*i*) default under quotas (62), (*ii*) violation by distributor of its non-compete obligations (63), (*iii*) default in respecting terms of payment (64).

The change of shareholdings of a distributor without the prior consent of supplier was also held to be a valid resolutory condition (as the agreement was concluded *intuitu personae*) (65).

Upon an application for termination under a specific resolutory clause, the court's authority, should the application be contested, is limited to determining whether the conditions giving rise to the application of the clause are present (66). Unless the clause is drafted in

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(59) Both doctrine and case law recognize that damages are often granted along the principles developed in case law under Articles X.36 and X.37 of the CEL (see doctrine cited by M. Wagemans, *op. cit*. p. 68).

(60) Bruxelles, 20 May 2009, *J.L.M.B.*, 2010, liv. 29, p. 1363.

(61) As mentioned by P.Kileste (*op. cit.*, p. 52), the validity of the "pacte commissoire" in a distribution agreement was first recognized in a decision of the Belgian Supreme Court of 19 April 1979 and that of a resolutory condition in a decision dated 30 June 1995 (Cass. 19 April 1979, *Pas*., 1979, I, p. 981; Cass., 30 June 1995, *Pas*., I, p. 724). See also, Bruxelles, 20 May 2009, *J.L.M.B.*, 2010, liv. 29, p. 1363.

(62) Liège, 27 April 2006, *R.D.C.*, 2007, p. 182; Anvers, 1 December 2008*, Limb. Rechtsl.*, 2009, liv. 4, p. 294; Bruxelles, 20 May 2009, *J.L.M.B.*, 2010, p. 1363.

(63) Comm. Bruxelles, 11 January 1999, unedited, cited by J.F. Fierens and A. Mottet Haugaard, *op. cit*., p. 44.

(64) Liège, 23 November 2004, *R.D.C.*, 2005, p. 962.

(65) Cass., 30 June 1995, *Pas*., I, p. 724.

(66) M. Wagemans*, op. cit.,* p. 71.

such general terms that the court must assess the seriousness of the fault to avoid that it be applied abusively, the court may not substitute its opinion to that of the parties as to whether such a fault or event justifies or not the termination of the agreement (67).

Nevertheless, the judge must determine whether the agreement clearly states that it could be terminated *de jure* (without notice), as the parties may have dispensed themselves of the obligation to give notice under Article 1146 of the Civil Code (68). For example, the formulation "*this agreement will terminate immediately, without notice or other formality if...*" was considered a general, direct, contractual waiver to give notice (69).

It is noteworthy that the court may deny granting termination based on a specific resolutory clause if it was not invoked at the time of termination, and if the court considers, following verification, that the clause is purely potestative or null, or if its application would constitute an abuse of law or an arbitrary or discriminatory termination (70).

3.4.3. Termination other than for Serious Fault.

3.4.3.1. Notice and Indemnity in Lieu of Notice.

Article X.36 of the CEL provides that unless one can invoke a serious fault of the other party, a party may not terminate an exclusive distribution agreement entered into for an indefinite term pursuant to Title 3 of Book X of the CEL otherwise than by "*giving a reasonable notice and fair compensation, to be determined by the parties when the agreement is terminated*". It further disposes that if the parties fail to reach an agreement, the court may fix such compensation in equity and taking into account customs and practices.

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(67) Liège, 15 June 2004, *R.D.C.*, 2005, p. 945; Liège, 23 November 2004, *R.D.C.*, 2005, p. 962.

(68) Article 1146 du Code civil: "*Damages are due only once the debtor has been put on notice to fulfil its obligation, except in cases where that which the debtor was obligated to give or do could only be given or done within a certain period of time that debtor has let expire*".

(69) Anvers, 1 décembre 2008*, Limb. Rechtsl.*, 2009, liv. 4, p. 294.

(70) For a more detailed analysis, see P. Kileste, *Quelques réflexions sur la licéité des conditions résolutoires expresses en matière de concession de vente exclusive à durée indéterminée*, *R.D.C.*, 1990, p. 717 *et seq.*

The unilateral right of termination contained in Article X.36 of the CEL is the application of the general common law principle that a party to an agreement for an indefinite term may terminate such agreement at any time, insofar as this right is not exercised with disregard or abusively.

Contrary to what one might think in reading Article X.36 of the CEL, the provision for notice and payment of fair compensation are not alternative obligations but rather compensatory obligations (71). The general rule or primary obligation remains the giving of a reasonable notice, failing which, or in cases where it is deemed insufficient, then the court will award the other party fair compensation (72).

In the absence of any notice given, the court will not re-activate the agreement nor order that a notice or additional notice be given (73).

Similarly, as termination is final and irrevocable, the party having triggered the termination may not, following termination and after the length of the notice period has been deemed insufficient by the aggrieved party, unilaterally prolong the duration of the notice period and thereby escape the payment of compensation to replace what should have been a proper notice period (74).

a) *Definition of Reasonable Notice*

Opposite what is the case for commercial agency agreements, the Belgian Legislator has not specifically defined what constitutes a "reasonable notice" with respect to distribution agreements, only stating that a "reasonable" notice must be given.

For close to forty years, case law and doctrine have considered a "reasonable notice" as being such period of time as is required by the terminated distributor to find a business opportunity equivalent to the one it had prior to such termination (75).' (76)

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(71) Cass., 28 June 1979, *Pas*., 1979, I, p. 1260.

(72) Cass., 6 November 1987, *R.D.C.*, 1988, p. 182; Cass. 24 April 1998, *R.D.C.,* 1999, p. 256; Cass. 4 December 2003, *Pas*., 2003, p. 1951.

(73) Comm. Liège, 16 April 2004, *D.A.O.R.*, 2004, p. 33.

(74) Bruxelles, 27 February 2003, *R.D.C.*, 2005, p. 929; Cass., 14 January 2010, *Pas*, 2010, liv. 1; p. 107; M. Wagemans, *op. cit*., p. 78; P. Kileste, *op. cit*., p. 63. Similarly, the party evicted from the agreement cannot escape the irrevocable character of the termination by demanding the extension of the agreement.

(75) See *inter alia*: Mons, 9 October 1989, *R.D.C.*, 1990, p. 683; Bruxelles, 20 June 1995, *R.D.C.*, 1996, p. 235; Mons, 16 January 1997, *R.D.C.*, 1998, p. 243; Comm. Hasselt, 28 January 1997, *R.W.*, 1999-2000, p. 262; Anvers, 19 March 2001, *R.D.C.*,

The definition of reasonable notice has progressively evolved.

In its decision of 10 February 2005 (77), the Belgian Supreme Court initiated the change by stating that, in order to satisfy the requirements of the law, the notice must "*allow the distributor to perform its obligations vis-à-vis third parties and raise a source of net revenues equivalent to those he lost, converting to different business activities as the case may be; it must at least allow the distributor to reduce certain fixed costs or find a source of revenues to cover its incompressible costs" and that a "supplier may not in all circumstances claim a notice period allowing it to find a business opportunity having all of the characteristics and effects as the one it has lost*" (78).

Following the decision of the Belgian Supreme Court of 20 June 2008 (79), a majority of case law considers that a reasonable notice period must allow the distributor to find a source of net revenues equivalent to that it has lost (80). It therefore seems that the other two criteria — the conversion of the distributor's activities and the performance of its obligation's towards third parties — are no longer required, although the court may take them into consideration as a measure of equity to guide it in its assessment (81).

b) *Form of Notice*

Title 3 of Book X of the CEL does not prescribe any particular form for the notice to be given.

2003, p. 524; Gand, 17 May 2002, *R.D.C.*, 2003, p. 528; Bruxelles, 28 January 2003, *R.D.C.*, 2004, p. 559; Comm. Gand, 23 June 2003, *T.G.R.*, 2003, p. 272.

(76) Cases of notice sent by a supplier are rare. In a decision of 23 September 1999 (*D.A.O.R.*, 2000, p. 55) the Brussels Court of Appeals stated that in such a case, the notice period to take into consideration should be determined "*in relation to the time needed by the supplier to find a distributor having the same characteristics as the one he is losing*".

(77) Cass, 10 February 2005, *J.L.M.B.*, 2005, p. 1440.

(78) Bruxelles, 25 March 2005, *R.D.C.,* liv. 10, p. 985; Bruxelles, 18 October 2007, D.A.O.R., 2008, liv. 86, p. 129; Bruxelles, 12 February 2008, *D.A.O.R.,* 2008, liv. 86, p. 136.

(79) Cass., 20 June 2008, *R.D.C.*, 2009, p. 259.

(80) Gand, 24 June 2009, *R.A.B.G.*, 2011, liv. 4, p. 279; Comm. Liège, 22 December 2011, *D.A.O.R.*, 2013, liv. 105-106, p. 111; Comm. Bruxelles, 24 October 2013, *R.D.C.*, 2015, liv. 1, p. 105; Gand, 3 September 2014, *NjW*, 2016, liv. 334, p. 34.

(81) P. Kileste and C. Staudt, *Rôle de l'équité, de la bonne foi et des usages dans les contrats de distribution commerciale*, in *Regards croisés sur la distributio: agence, concession et franchise*, Larcier, 2015, p. 31.

The jurisprudence is unanimous in finding that the recipient of a notice must be informed with certainty that the sender wishes to terminate the agreement so that it may take appropriate measures to commercially organise the end of its activities and find, as the case may be, replacement revenues (82).

It therefore becomes important that the sender of the notice be able to prove the notification (preferably by registered mail with acknowledgment of receipt) and indicate precisely from when such notice period shall run (83).

c) *Length of Notice Period*

Once the notice has been given, the parties are free to negotiate the length of the notice period or the indemnity to be paid *in lieu* of the notice.

Article X.36 of the CEL prescribes that if the parties cannot agree upon the notice period, then the court must determine same in equity, taking into consideration any relevant customs and practices, as the case may be.

Such determination in equity gives the court wide discretion, so much so that case law has come to accept that the court may take into consideration all of the circumstances of which it has knowledge at the time of its decision (84).

Hence the role of the court is to determine, taking into account the particular circumstances of each case, the theoretic length of the reasonable notice period necessary for an evicted distributor to find an equivalent business situation, through perhaps converting his business activities to others, as the case may be.

In assessing the length of the notice period, the courts (85) usually consider the following criteria:

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(82) Bruxelles, 23 September 1987, *R.D.C.*, 1988, p. 621; Bruxelles, 12 June 2007, *J.L.M.B*, 2008, p. 32.

(83) Failing which the notice period shall commence at such time as the recipient has knowledge of the wishes of the sender to terminate the agreement after the specific period.

(84) Cass., 16 May 2003, *D.A.O.R.*, 2003, p. 33; Cass., 7 April 2005, *J.L.M.B.*, 2005, p. 1448; Cass., 20 June 2008, *R.D.C.*, 2008, p. 259; Cass., 14 January 2010, *Pas.*, 2010, liv. 1, p. 107; Bruxelles, 6 August 2013, *R.A.B.G.*, 2016, liv. 8-9, p. 614; Cass. 6 May 2016, *D.A.O.R.*, 2016, liv. 119, p. 31.

(85) *Inter alia* Cass., 10 February 2005, *J.L.M.B.*, 2005, p. 1440; Bruxelles, 12 February 2007, *D.A.O.R.*, 2008, liv. 86, p. 138; Bruxelles, 18 October 2007, *D.A.O.R.*, 2008, p. 129; Comm. Bruxelles, 24 October 2013, *R.D.C.*, 2015, liv. 1, p. 105.

— the geographic area or territory covered,

— the proportion that the licensed business represents in relation to distributor's total business activities,

— the nature and recognition of the licensed products and the existence of competing products,

— the importance and progression of the licensed products revenues,

— investments made by the distributor in the operation of the distributorship, and

— the profit margin earned on the licensed products and the effects termination will have on the other activities of the distributor.

On the basis of these criteria, case law has through recent years allowed for notice periods varying greatly from 3 to 48 months (86).

It must be pointed out that in their decisions, the courts do not always mention which factors they considered in determining a notice period, nor the relative importance of the criteria and, even though they usually apply similar objective criteria, the fact that they decide in equity based on subjective criteria accounts for this great variability in their determinations.

d) *Award and Calculation of Indemnity in Lieu of Notice*

Should termination occur that is not justified by a serious fault and without prior notice or with an insufficient notice period given, the distributor may claim an indemnity *in lieu* of notice (87).

As is the case for the length of notice, the court will intervene to determine the indemnity only if the parties are unable to agree after the termination of the agreement on the amount payable as indemnity *in lieu* of notice.

The indemnity *in lieu* of notice is defined as "*destined to compensate for lost revenues due to the failure to give a reasonable notice and, more specifically, to compensate for the loss of profits that the distributor could have made during the notice period that should have been given. Accordingly, it must be calculated so that the distributor gets the*

(86) For a more detailed analysis of the decisions and the impact of the criteria used to assess the length of the notice period, see *inter alia*: M. Wagemans, *op. cit.*, p. 94 *et seq.*; P. Kileste, *op. cit.*, p. 74 *et seq.*; P. Kileste and P. Hollander, *op. cit.*, p. 216 *et seq.*

(87) Art. X.36, 1 of the CEL.

equivalent to what it would have realized if the proper notice had been given (88)".

The Legislator has not specified a method of calculation of the indemnity. Through the years, case law has at times considered the semi-net profits (89), defined as the net profits before taxes increased by incompressible general costs, i.e. the costs intricately linked to the distribution that the distributor must continue paying after termination (such as rent, fixed costs, etc.), and at other times the semi-gross profits (90), defined as the gross profits reduced by compressible general costs, i.e. those costs that can immediately be reduced. Both methods should usually yield similar results.

Case law also varies with respect to the period to be considered for the evaluation of the semi-net and semi-gross profits.

The reference period should be that which best reflects the economic value of the concession prior to its termination, taking into account any particular circumstances as well as the state of the relationship between the parties at that time (91). As a consequence, the judge, who decides in equity (92), will often disregard in its calculations the year of termination, as the notice given may have had a negative impact on the turnover of the business.

In general, the period considered will be that of 2 or 3 years preceding the termination of the relationship.

It should also be noted that in circumstances of loss-making concessions, the courts have been known to refuse to award an indemnity *in lieu* of notice.

Facing complex calculations, the court will often resort to appointing valuation experts or will itself fix an indemnity *ex aequo et bono*.

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(88) Bruxelles, 6 May 2004, *R.D.C.*, 2005, p. 72; Gand, 27 June 2005, *N.j.W.,* 2006, p. 416; P. Kileste, *op. cit.*, p. 88.

(89) Bruxelles, 22 November 2001, *J.T.*, 2002, p. 242; Comm. Bruxelles, 13 March 2003, *R.D.C.*, 2005, p. 82.

(90) Liège, 9 November 2006, *R.D.C.*, 2007, p. 614; Gand, 24 June 2009, *R.A.B.G.*, 2011, liv. 4, p. 279; Liège, 23 May 2011, *D.A.O.R.*, 2011, liv. 100, p. 540.

(91) Bruxelles, 13 March 2003, *R.D.C.,* 2005, p. 82; see also Liège, 24 November 2014*, J.L.M.B.*, 2017, liv. 19, p. 909.

(92) Art. X.36, 2 of the CEL.

3.4.3.2. Additional Indemnity.

Article X.37 of the CEL (93) entitles the distributor (94), whose agreement has been terminated for a cause other than its serious fault, to an additional equitable indemnity, regardless of whether a sufficient notice was given (or an indemnity *in lieu* of notice). This additional indemnity is to compensate for any enrichment of the supplier following the termination and any damages suffered by the distributor which would not have been compensated by the reasonable notice or fair compensation. It considerably strengthens the distributor's protection.

The additional indemnity is calculated taking into account the following three elements:

a) the notable increase in client base brought by the distributor and that will remain with the supplier after termination of the agreement;

b) the costs incurred by the distributor to operate the distributorship and that will benefit the supplier after termination of the agreement; and

c) the amounts payable to any employees the distributor must terminate following termination of the agreement.

a) *Goodwill Indemnity*

Article X.37 of the CEL places three cumulative conditions, the burden of proof of which rests with the distributor, which must be met to entitle the distributor to receive a goodwill indemnity (95):

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(93) Art. X.37 CEL: "*If an agreement subject to Article X.35 is terminated by the supplier for a cause other than the serious fault of the distributor, or if distributor terminates the agreement by reason of a serious fault of the supplier, the distributor may claim an additional equitable indemnity. This indemnity, as the case may be, is calculated taking into consideration the following factors:*

1° The considerable increase of client base brought by the distributor and that will remain with supplier after the termination of the agreement;

2° The costs incurred by the distributor to operate the concession and that will benefit the supplier after termination of the agreement;

3° The amounts payable to any employees the distributor must terminate following termination of the agreement. If the parties cannot agree, the court will determine in equity and as the case may be, taking into account any practices and usages".

(94) It is noteworthy that the law does not award the supplier an additional indemnity upon termination by the distributor.

(95) Proof may be established by any legal means, including by presumption (see *inter alia*: Liège, 30 November 2004, *R.D.C.*, 2005, p. 966); Comm. Tongres, 15 November 2011, *Limb. Rechtsl.*, 2015, liv. 1, p. 50.

(i) *The increase must be considerable*

The contribution to the client base must be important and is traditionally measured by comparing turnover, number of customers or sales made on licensed products between the beginning and end of the agreement (96).

(ii) *The distributor must be responsible for the increase*

The distributor must establish that it has increased the customer base following efforts made, such as advertising and promotion of licensed products, investments, etc. The fact that the distributor was the first distributor of supplier's products is generally considered as an important factor.

(iii) *The customer base must remain for the benefit of supplier after termination*

The distributor must also establish that the increase will remain for the benefit of the supplier after termination of the agreement in order to be entitled to the goodwill indemnity. As for the proof required, the Belgian Supreme Court has clearly recognized the judge's wide discretionary power in such determination, in that a distributor is not required to establish the effective transfer of customers to supplier, a reasonable presumption of such a transfer being sufficient in itself (97). Case law has recognized the following factors as creating a valid presumption: the brand awareness of the supplier's product; the retirement of the distributor from any commercial activities following termination of the agreement; the distributor providing the supplier with its customer list; at the request of the supplier, the announcement by distributor to its customers of the change of distributor (98).

As is the case for the indemnity *in lieu* of notice, the Legislator does not state how the additional goodwill indemnity must be calculated. Article X.37 of the CEL states only that such indemnity must be equitable.

Although the basis for calculating varies widely, the courts tend increasingly to rely upon the gross profits (gross margin) as the basis of calculation as the customer base is considered an asset, the value of which depends upon its capacity to generate profits and it is then

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(96) Cass. 6 May 2016, *D.A.O.R.*, 2016, liv. 119, p. 31.

(97) Cass., 7 January 2005, *R.D.C.*, 2005, p. 916.

(98) For a more detailed analysis, P. Kileste and P. Hollander, *op. cit.*, p. 227 *et seq.*; J.P. Fierens and A. Mottet Haugaard, *op. cit.*, p. 94 *et seq.*

appropriate to take into account the annual gross profits generated by this customer base (99).

As is also the case for the indemnity *in lieu* of notice, equity will guide the court in its determination and a judge may always take into account the situation of the distributor after the termination of the agreement (100).

b) *Indemnity for costs*

Article X.37 of the CEL also provides for the recovery of costs invested in the operation of the distributorship and which will benefit the supplier after the termination of the agreement.

The distributor must establish a prejudice, that the prejudice has not been compensated for by another indemnity and that the costs will truly benefit the supplier after termination of the agreement. Costs claimed often include advertising expenses as well as others that contribute to the reputation of the licensed products. The Belgian Supreme Court has also recognized as eligible for indemnity certain after-sales costs (101). Normal operating costs and expenses of the business, such as for the purchase of computer workstations cannot be claimed under this indemnity (102).

c) *Indemnity for amounts paid to terminate employees*

Finally, Article X.37 of the CEL allows the distributor to make a claim for amounts paid to terminate employee contracts resulting from the termination of the distribution agreement.

The distributor must establish that the employee termination is due to the termination of the agreement, which entails showing that the employee was actually engaged in the business of the concession (103).

Only severance amounts payable to those employees who were dispensed from working out the notice period may be considered, as

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(99) Bruxelles, 27 February 2003, *R.D.C.*, 2005, liv. 9, p. 929; Cass. 20 June 2008, *Pas.*, 2008, p. 1590; Comm. Liège, 22 December 2011, *D.A.O.R.*, 2013, liv. 105-106, p. 111.

(100) Cass. 26 April 2010, *J.L.M.B.*, 2010, liv. 29, p. 1358; Bruxelles, 6 August 2013, *R.A.B.G.*, 2016, liv. 8-9, p. 614.

(101) Cass. 20 June 2008, *Pas.*, 2008, p. 1590.

(102) Bruxelles, 1 April 2003, *R.D.C.*, 2004, p. 569.

(103) As for the impact of the timing of the termination of the employee on the court's judgment, see doctrinal debate and esp.: M. Wagemans, *op. cit.*, p. 140 *et seq.*; J.F. Fierens and A. Mottet Haugaard, *op. cit.*, p. 101 *et seq.*

well as pre-pension fees or termination bonus or premiums (104). Notwithstanding the foregoing, it has nevertheless been held that remuneration paid to the employees who worked out their notice period could be claimed as an indemnity for unavoidable costs due to termination of the agreement (105).

3.5. Inventory and Equipment upon Termination.

The return or repurchase of inventory and equipment by the supplier upon termination is not provided for in Title 3 of Book X of the CEL, but often raises issues which must be dealt with.

This may quickly become a delicate situation as no protection is provided by law. Moreover during the notice period, the distributor is required to offer its customers the products and services as usual. Accordingly, during the notice period, the distributor must continue to maintain sufficient inventory, which is often an impediment to the reduction of such inventory leading to the effective date of termination (106). The question remains as to whether the supplier may be forced to repurchase the remaining inventory and specific equipment in distributor's possession at the end of the notice period.

Doctrine and case law generally dictate that absent any specific contractual obligation to the contrary, the supplier must repurchase leftover equipment and inventory and pay distributor adequate compensation therefor.

This repurchase obligation is generally justified by the application of the general principle of the good faith performance of one's obligations (107). The obligation will only apply with respect to inventory that is not stale-dated or obsolete and that has preserved its value and

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(104) Cass. 26 April 2010, *Pas*., 2010, liv. 4, p. 1263; Comm. Tongres, 15 November 2011, *Limb. Rechtsl*., 2015, liv. 1, 50.

(105) Bruxelles, 6 May 2004, *R.D.C*., 2005, p. 72.

(106) L. DU JARDIN, *Les contrats de distribution sélective*, Bruylant, 2014, p. 189.

(107) Cass. 31 October 1997, *R.D.C*., 1998, p. 228; Liège, 15 June 2004, *R.D.C*., 2005, liv. 9, p. 945; Liège, 2 November 2006, *J.L.M.B*., 2007; liv. 29, p. 1223; P. Kileste, P. Hollander and C. Staudt, *La résiliation des concessions de vente, 50 ans d'évolution de la loi du 27 juillet 1961*, Anthemis, 2011, p. 169; P. Kileste and C. Staudt, *Rôles de l'équité, de la bonne foi et des usages dans les contrats de distribution commerciale*, in *Regards croisés sur la distribution: concession, agence et franchise,* Larcier, 2015, pp. 4 *et seq.* For other interpretations, see M. Wagemans, *op. cit*., p. 142 *et seq.*; J.F. Fierens

usefulness, characteristics, the burden of proof of which lie with the distributor. The obligation will not be recognised in cases where the agreement has been terminated for serious fault of the distributor or if the distributor has terminated the agreement without having given the required reasonable notice.

In cases where the parties have agreed as to the return of inventory and equipment upon termination, the courts tend to encourage the performance of such obligations as per the agreement of the parties and in application of the general principles such as those of Article 1134 of the Civil Code (108).

In practice, failing specific criteria agreed upon between the parties in their agreement, the court will appoint an expert to determine the inventory and equipment to be repurchased as well as their value (109).

3.6. Non-compete Clauses.

Unless otherwise agreed, following termination of the agreement, the distributor is free to carry on any business activity it wishes, including any in competition with those of the supplier. Nevertheless, it is possible to include a non-compete clause in a distribution agreement.

Such clauses, that apply once the agreement has ended, must not infringe upon distributor's freedom of trade and commerce.

It should be reminded that a post-contractual clause in a distribution agreement can only benefit from the exemption contained in Regulation (EU) no. 330/2010 (110) if (*i*) it is required for the protection of the know-how that was transmitted from the supplier to the distributor; (*ii*) it is limited to the premises and property from which the distributor carried on its business activities during the term of the

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and A. Mottet Haugaard, *op. cit.*, p. 102 *et seq.*; P. Kileste, P. Hollander, *op. cit.*, p. 231 *et seq.*

(108) Article 1134 of the Civil Code: "*Agreements legally entered into become law for the parties that have made them. They may only be revoked by mutual consent or for causes authorized by law. They must be performed in good faith*".

(109) Comm. Anvers, 21 May 1999, *R.D.C.*, 1999, p. 887; Liège, 15 June 2004, *R.D.C.,* 2005, liv. 9, p. 945.

(110) Regulation (EU) no. 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices.

agreement; and (*iii*) the clause is limited in time to a period of one year following termination of the agreement.

Accordingly, in order to be valid, a non-compete clause must be limited in time, location and scope of prohibited activities.

3.7. Fixed Term Distribution Agreements.

As previously noted, Title 3 of Book X of the CEL only applies to the unilateral termination of certain distribution agreements.

Fixed term distribution agreements remain governed by the general principles of law and terminate at the agreed-upon date in the agreement. Article X.38 of the CEL (111) contains two exceptions to this general rule, in order to avoid situations whereby successive fixed term agreements would attempt to circumvent the rules applicable to agreements entered into for an indefinite term.

Article X.38,1 of the CEL requires that a notice of termination be given between 3 and 6 months prior to the termination of a fixed term distribution agreement by registered mail. Failing such a notice, the agreement will be deemed renewed for an indefinite period of time or for the period specified in the automatic renewal clause of the agreement, as the case may be.

For its part, Article X.38,2 of the CEL provides that following two renewals, either by application of a renewal clause or by automatic renewal, any further renewal will be deemed a renewal for an indefinite period of time.

Once the provisions of Article X.38 of the CEL have applied and we find ourselves in the presence of an agreement for an indefinite term, then the protective provisions of Articles X.36 and X.37 of the CEL shall apply, among other things, with respect to reasonable notice and compensation upon termination (see *supra*).

In all other respects the termination of fixed term distribution

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(111) Art. X.38 of the CEL: "*When a distribution agreement to which the present chapter applies is entered into for a fixed term, the parties thereto shall be deemed to have agreed to a renewal thereof, either for an indefinite period of time, or such period of time as appears in an automatic renewal clause, unless there will have been given notice of termination between three and six months prior to termination.*

Following the second renewal of a distribution agreement entered into for a fixed term, whether the terms of the original agreement have been modified or not, or following the second automatic renewal of the agreement under a clause of the agreement to this effect, any further renewal shall be deemed for an indefinite period".

agreements remain subject to the application of the general principles of law which govern obligations (112). As a consequence, the victim of a premature termination will only be able to claim damages calculated on the basis of losses suffered and lost revenues due to the fact that the agreement was not performed to its intended term (113).

3.8. Sub-distributors.

According to Article X.40 of the CEL (114), insofar as they fall within the definition of distribution agreements of Article I.11, 3° of the CEL, the provisions of Title 3 of Book X of the CEL shall apply to sub-distribution agreements.

Article X.40, 2 of the CEL allows for a direct action by the sub-distributor against the principal supplier (excluding any action by the sub-distributor against the principal distributor) when a sub-distribution agreement entered into for an indefinite term is terminated following the termination of the principal agreement (*i*) independently of the will of the principal distributor, or (*ii*) without there having occured a serious fault of the latter.

By derogating from the general rule that agreements can only produce their effects as between their parties, the Legislator has once more acted to protect the expropriated distributor. We are unsure as to the effectiveness of this measure as the problem is simply moved up, forcing the sub-distributor to take action against the principal supplier which may often be a foreign entity, which can make things much more difficult in terms of performance.

Article X.40, 3 of the CEL provides for notice to be given by a distributor to a sub-distributor under a sub-distribution agreement

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(112) Gand, 18 September 2013, *R.A.B.G.*, 2016, liv. 8-9, 606.

(113) Comm. Namur, 12 September 2000, *R.D.C.*, 2003, liv. 6, p. 521.

(114) Article X.40 of the CEL: "*The rules set out in the preceding Articles shall apply to distribution agreements entered into between one or more sub-distributors.*

If a sub-distributor agreement entered into for an indefinite term is terminated upon termination of distributor's agreement for reasons other than by the will or the fault of the distributor, then the sub-distributor may only invoke its rights under Articles X.36 and X.37 against the party having caused the termination of the original agreement.

When a sub-license agreement is for a fixed term ending at the same time as the principal agreement, then a distributor who receives notice of termination from the supplier, shall have for all intents and purposes a delay of 14 clear days from its receipt of notice to itself send notice of termination to a sub-distributor".

entered into for a fixed term. In order that the principal distributor may respect the delays for notice under Article X.38 of the CEL, the principal distributor shall have a delay (additional) of 14 clear days from the time it receives notice from the principal supplier to give notice to its sub-distributor.

3.9. Are the Provisions of Title 3 of Book X of the CEL immediately applicable mandatory provisions?

3.9.1. Under the 1961 Law.

The 1961 Law was mandatory. It remains applicable to distribution agreements entered into before 31 May 2014 (115).

Its Article 6, 1 stated that the provisions of the 1961 Law "*shall apply notwithstanding anything to the contrary which may be agreed upon before the termination of the agreement*".

As the distributor is usually in an economically dependent position vis-à-vis the supplier, the Belgian Legislator wished to protect the distributor by prohibiting it to waive any of the advantages provided by the 1961 Law during the term of the agreement (116). It is only once that the termination notice has been given that the parties are free to negotiate and agree upon the consequences of their ruptured relationship. Indeed, the Belgian Supreme Court clearly decided upon the mandatory nature of the 1961 Law, stating that "*its objective was to ensure, in all circumstances, that a distributor may avail itself of the protection offered by Belgian law, except where it has agreed to waive such protection by an agreement entered into after the termination of the distributorship*" (117) (we underline).

Not only was this legislation qualified as imperative, its provisions were also considered immediately applicable mandatory provisions, such as police law (118). According to Article 4 of the 1961 Law "*the*

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(115) Date of entry into force of the CEL.

(116) M. Wagemans, *op. cit.*, p. 165 *et seq.*

(117) Cass., 27 May 1971, *Pas.*, 1971, liv. 1, p. 914.

(118) F. Rigaux and M. Fallon, *op. cit.*, pp. 515-516, consider that "*the police laws include those provisions of private law that the Legislator has determined should have territorial effect. The application of these laws is a breach of the principle of independent laws justified by the concern with protecting one of the parties with imperative provisions*".

distributor may, upon termination of termination of an agreement that produces its effects in all or part of Belgium, in any event assign the supplier in Belgium, either before the court of its own domicile or before the court of the domicile or the registered office of the supplier. In cases where the dispute is brought before a Belgian court, it will exclusively apply Belgian law".

As mentioned earlier, the Legislator's original idea was to protect the distributor in purely domestic situations; but also in situations presenting certain foreign elements such as a non-Belgian contracting party or a contractual territory partially outside of Belgium.

The only obstacles to the application of the 1961 Law have been its auto-limitative character, on the one hand, and the principle of the primacy of private international law, on the other.

With respect to the auto-limitative character of the 1961 Law, it must be pointed out that its Article 4 (now Article X.39 of the CEL) applies only to the unilateral termination of exclusive distribution agreements entered into for an indefinite term which fit into one of the three categories mentioned by the law (exclusive agreements, quasi-exclusive agreements or agreements imposing substantial obligations on the distributor) and which produce their effect, in even the slightest proportion, in Belgium. Therefore the 1961 Law is imperative only within the situations it describes and when an agreement produces effects in Belgium; Article 4 will not be applicable outside the material and territorial limits of the 1961 Law (119).

Moreover, in recent years, the evolution of international conventions with respect to conflicts of laws and jurisdictions as well as the principle of primacy which characterizes them (120) have considerably limited the scope of application of the 1961 Law (121).

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(119) The provisions of Article 4 of the 1961 Law cannot be invoked by a distributor seeking termination of the agreement for a serious fault of the supplier under common law, as is the case for the other issues connected to the application of a resolutory clause, the handling of inventory, etc.

(120) In its decision of 27 May 1971, the Belgian Supreme Court affirmed the principle of primacy of international law in Belgium. This principle is reaffirmed in Article II.1 of the CEL: "*Subject to the application of international treaties, EU law or other specific legislation, this Code contains the general provisions applicable to economic matters of the jurisdiction of the federal authority*".

(121) For a more detailed analysis of private international law issues with respect to distribution agreements, see M. Wagemans, *op. cit.*, p. 171 *et seq.*; P. Hollander, *op. cit.*, p. 128 *et seq.*

The supranational rules of reference relating to jurisdictional competence can be found in Regulation (EU) No. 1215/2012 of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters ('Brussels I'), which applies to judicial actions instituted after 10 January 2015 and in the Lugano Convention of 30 October 2007 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, which applies to relations among Member States of the EU, Switzerland, Iceland and Norway. In situations where the supplier has its head office outside the signatory countries of Brussels I or the Lugano Convention, then the rules governing the competence of Belgian courts are those contained in the Belgian Code of International Law (122).

With respect to conflicts of laws, the Belgian court will determine the law applicable to the distribution agreement following the principles contained in Regulation (EC) no. 593/2008 of 17 June 2008 on the law applicable to contractual obligations (the "Rome I"), which replaced the Rome Convention of 19 June 1980 (the "Rome Convention") and applies to agreements entered into after 17 December 2009, as well as the Belgian Code of International Law should the agreement contain elements outside the EU.

More particularly, with respect to the rules on conflicts of laws, if the parties chose by agreement applicable law other than Belgian law or by absence of choice, a law other than Belgian law was applicable, then the 1961 Law would remain applicable under Article 7 of the Rome Convention (123).

Under Rome I, the European Legislator introduced the novel normative notion of overriding mandatory legislation (Art. 9.1) and

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(122) The Law of 16 July 2004 implementing the Code of private international law, *M.B.*, 27 July 2004, p. 57344.

(123) Art. 7 of the Rome Convention: "*When applying under this Convention the law of a country, effect may be given to the mandatory rules of the law of another country with which the situation has a close connection, if and in so far as, under the law of the latter country, those rules must be applied whatever the law applicable to the contract. In considering whether to give effect to these mandatory rules, regard shall be had to their nature and purpose and to the consequences of their application or non-application.*

Nothing in this Convention shall restrict the application of the rules of the law of the forum in a situation where they are mandatory irrespective of the law otherwise applicable to the contract".

makes a distinction between local (Art. 9.2) and foreign overriding mandatory rules (Art. 9.3) (124).

Noteworthy are the more restrictive rules on foreign overriding mandatory rules introduced by Rome I and the consequent weakening of the Belgian distributors' situation before foreign courts. Article 9.3 of Rome I doubly limits the application of foreign overriding mandatory rules: geographically, by limiting their application to the place of the performance of the agreement, and as to their content and effect, those overriding mandatory provisions must have rendered the performance of the agreement unlawful.

One can see the impact of this norm on the 1961 Law in that Belgian distributors may no longer be able to invoke the 1961 Law before a foreign court. Indeed the 1961 Law only concerns the termination of an agreement and is not of such a nature as to make the performance of the agreement unlawful.

Finally, as mentioned *supra* (Section 2.5), the doctrine is divided with respect to the consequences of the *Unamar* decision (125) on the application of the 1961 Law as an overriding mandatory legislation. According to certain authors, the Belgian courts will no longer be able to escape the application of the foreign law chosen by the parties by simply stating that Article 4 of the 1961 Law (now Article X.30 of the CEL) renders Belgian law exclusively applicable when the agreement produces effects in all or part of Belgium (126).

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(124) Art. 9 of the Rome I: "*Overriding mandatory provisions are provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under this Regulation.*

Nothing in this Regulation shall restrict the application of the overriding mandatory provisions of the law of the forum.

Effect may be given to the overriding mandatory provisions of the law of the country where the obligations arising out of the contract have to be or have been performed, in so far as those overriding mandatory provisions render the performance of the contract unlawful. In considering whether to give effect to those provisions, regard shall be had to their nature and purpose and to the consequences of their application or non-application".

(125) E.C.J., *Unamar v. Navigation Maritime Bulgare,* 17 October 2013, C-184/12; also *J.T.*, 2014, p. 302.

(126) See *supra* note 26 and also T. Bontinck and C. Cornil, *Le contrat de distribution intra-communautaire. La rupture du contrat de distribution intra-communautaire. Exemples français et belge*, in *Revue de jurisprudence commerciale*, 2015, n. 1, p. 16.

3.9.2. The Provisions of Title 3 of Book X of the CEL.

The provisions of the 1961 Law were abrogated by the Law of 2 April 2014 to be incorporated within Title 3 of Book X of the CEL.

As mentioned *supra* (Section 3.8.1), the 1961 Law was imperative legislation given that paragraph 1 of its Article 6 states that it "*shall apply notwithstanding anything to the contrary which may be agreed upon before the termination of the agreement*".

Yet unexpectedly, the Legislator did not codify Article 6 of the 1961 Law into the CEL, so that currently nothing in the CEL declares that the rules contained in Title 3 of Book X of the CEL (Articles X.35-X.40 of the CEL) and pertaining to exclusive distribution agreements concluded after 31 May 2014 (the date of effect of Book X of the CEL) are mandatory provisions (127).

Under the 1961 Law, the imperative character of the rules originated from the joint interpretation of Article 4 (now Article X.39 of the CEL) (128) and Article 6.

Absent any legislation attributing an overriding mandatory character to Title 3 of Book X of the CEL and consequently to Article X.39 of the CEL, it seems legitimate to wonder whether the Belgian provi-

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(127) The 2014 Law contains transitory rules governing the entry into force of the provisions of the CEL. Its Article 10.1 states that "*without prejudice to any specific legal provisions, the provisions of Book X shall immediately apply to new agreements entered into following the entry into force of its provisions*". Article 10.3 goes on to state that "*the provisions of the Law of 27 July 1961 concerning the unilateral termination of exclusive distribution agreements entered into for an indefinite period of time remain applicable, notwithstanding anything to the contrary, to such agreements entered into prior to the abrogation of the aforementioned Law*".

In its opinion n. 54.379/1 of 29 November 2013, the Belgian Council of State had remarked that Article 6 of the 1961 Law was a transitory provision, whereas the draft Law of 2 April 2014 inserting Book X into the CEL itself already contained a specific transitory provision (Article 10.3, see *supra*). Although the Belgian Council of State's remark applied only with respect to Article 6.2 of the 1961 Law (transitory provision stating that the provisions of the 1961 Law shall apply to agreements entered into before the entry into force of the Law), Article X.41 of the draft CEL was deleted, taking with it the imperative character of the law (originally stated in Article 6.1 of 1961 Law).

(128) Art. X. 39 CEL: "*The injured distributor, in situations of termination of an agreement that produces its effects in all or part of Belgium, may in all cases assign the supplier in Belgium, either before a judge of its own domicile or before a judge of the domicile of the supplier or the head office of the supplier. In cases where the dispute is brought before a Belgian court, it will exclusively apply Belgian law*".

sions may still be considered imperative norms and overriding mandatory rules for agreements entered into after 31 May 2014.

One may also believe that the deletion of Article 6 of the 1961 Law was a simple mistake and that the courts will not alter their hitherto interpretations. We must wait for the evolution of case law on this issue or an intervention of the Legislator to clarify this remaining ambiguity (129).

4. The Franchise Agreement.

4.1. Definition and Characteristics of the Franchise Agreement.

Although the franchise format is a well-known figure in our current economy and certainly one of the most popular forms of distribution, it does not have a legal definition in Belgian law.

Nevertheless, a definition appears in the European Code of Ethics for Franchising:

"*Franchising is a system of marketing goods and/or services and/or technology, which is based upon a close and ongoing collaboration between legally and financially separate and independent undertakings, the Franchisor and its individual Franchisees, whereby the Franchisor grants its individual Franchisee the right, and imposes the obligation, to conduct a business in accordance with the Franchisor's concept.*

The right entitles and compels the individual Franchisee, in exchange for a direct or indirect financial consideration, to use the Franchisor's trade name, and/or trade mark and/or service mark, know-how, business and technical methods, procedural system, and other industrial and/or intellectual property rights, supported by continuing provision of commercial and technical assistance, within the framework and for the term of a written franchise agreement, concluded between the parties for this purpose" (130).

It is generally agreed that the following elements characterize the franchise agreement:

• *The ownership, or the right of use by the franchisor, of rallying signs to attract customers* (name, signs, brands, symbols, logos, etc.)

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(129) On this matter, see also P. Hollander, *op. cit.*, p. 128 *et seq.*

(130) Article 1, par. 1 and 2 of the European Code of Ethics for Franchising: *http://www.eff-franchise.com/Data/Code%20of%20Ethics2.pdf*

resulting in public recognition of the product and services and allowing their differentiation from competing products and services, thereby identifying and unifying the members of a same franchise network;

• *the transmission* from franchisor *to franchisee*, *of its know-how and the right to use its brand* and distinctive signs in general.

Know-how consists of a collection of non-patented practical information resulting from the experience of the franchisor, tested and proven by the franchisor. It must be secret, substantial (in that it must be specific to a particular franchise) and identified (complete and detailed description required) ([131]);

• *the support of franchisee by franchisor,* prior to the beginning of franchisee operations (for example, help in choosing premises and with lease negotiations, recommendations for suppliers, initial training of franchisee and staff on technical, commercial and management matters, help with launch advertising campaign, etc.) as well as throughout the performance of the agreement (permanent training, assistance with accounting, marketing, etc.) ([132]).

Note however, that the obligation of support does have its limits as the franchisee is and must remain an independent business from that of the franchisor (see *infra*);

• *the obligation of the franchisee to conduct its business according to the rules of the network;*

• *the payment of an entry fee and periodic royalties by the franchisee* as a compensation for the transmission of franchisor know-how, rights to use franchisor's brand, continued support, etc.;

• *the* intuitu personae *nature of the franchise agreement with respect to the* franchisee, which is a direct consequence of the transmission of name and know-how to franchisee, as well as the duty of the parties to closely collaborate;

• *the independence between franchisee and franchisor*, failing which the agreement could risk requalification as an employment agreement.

4.2. Types of Franchise and Distinction with Distribution.

There are various types of franchises:

([131]) For a complete definition of know-how, see *supra* Section 2.2, and Art. 1 of the European Code of Ethics for Franchising.

([132]) P. Kileste and C. Staudt, *Contrat de Franchise*, *op. cit*., p. 9.

• *The Distribution Franchise*, the object of which is the sale by the franchisee of products manufactured or sold by the franchisor. In the case of products sold by the franchisor, also the most common type of situation, the franchisor basically plays the role of a central purchasing agency, proposing products and/or authorized suppliers to its franchisees. This type of franchise is common in food distribution, DIY and bookstands.

Since this type of franchise revolves around sales, its distinction from the distribution agreement has raised controversy and it carries the risk of requalification of the relationship.

You will recall that Article I.11, 3 of the CEL defines the distribution agreement as "*an agreement whereby a supplier grants to one or more distributors, the rights to sell, in their own name and for their own account, the products that it manufactures or distributes*".

Given the wide scope of the wording of this definition, it will not always be easy to distinguish between a distribution franchise and a classic distribution agreement, especially in cases where the brand, transmission of know-how and obligations of support are an accessory to the franchisee's rights to purchase products from franchisor (133).

Both the doctrine (134) and the case law (135) are greatly divided and the consequences are great, as this brings into question the application of the protective measures of Title 3 of Book X of the CEL upon termination of distribution franchise agreements (reasonable notice or payment of indemnity and payment of additional equitable indemnity).

• *The Services Franchise*: The franchisor has developed and put into practice a novel method to provide certain services. This know-

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(133) Liège, 9 January 2009, *J.L.M.B.,* 2011, liv. 11, p. 1010.

(134) For an in-depth examination, see P. Kileste and C. Staudt, *De l'application de la loi du 17 juillet 1961 à un contrat de franchise ou les véhicules hybrides échappent-ils au code de la route?*, J.L.M.B., 2011, p. 1013; P. Kileste and C. Staudt, *Contrat de franchise*, *op. cit*., p. 125 *et seq*.; P. Demolin and V. Demolin, *Le contrat de franchise. Les règles juridiques applicables au contrat de franchise en Belgique. Analyse et commentaire de quinze années de jurisprudence 1995-2010,* Larcier, 2011, p. 57 *et seq*.

(135) In favour of application, see, *inter alia,* Gand, 12 October 1994, *R.D.C*., 1919, p. 501; Comm. Liège, 15 September 1995, *J.L.M.B*., 1997, p. 1658; Liège, 19 March 1998, *R.D.C*., 1999, p. 278; against application, see, *inter alia*, Bruxelles, 11 April 1997, *R.D.C.,* 1999, p. 264; Liège, 19 March 1998, *D.A.O.R.*, 1999, liv. 48, p. 79; Anvers, 20 September 2004, *R.D.C.,* 2007, p. 172; Mons, 26 April 2007, *R.D.C*., 2007, p. 1024; Liège, 9 January 2009, *J.L.M.B.,* 2011, liv. 11, p. 1010.

how is then transmitted to the franchisee who uses it to provide the same services to its own customers. This type of franchise is popular for hotels, hair salons and barber shops, car rental and cleaning and maintenance services.

The success of this type of franchise depends greatly upon the quality of the know-how being transmitted as well as the precision with which the franchisee is able to apply the instructions received from franchisor in delivering the services to its own customers.

It is to be noted that the services franchise may sometimes be associated with a distribution franchise, when, for instance, the franchisee must use as well as sell franchisor-branded products (beauty salons or hair salons for example) (136).

• *The Industrial Franchise:* (rarer, for example: Coca-Cola®, Yoplait®, Lotus®, etc.) allows franchisor to de-centralize its production by granting franchisee a dual license: (*i*) to manufacture products according to franchisor norms and instructions, and (*ii*) to sell the products under the brand name of the franchisor.

• *The Master Franchise:* currently used by many brands for international expansion. An agreement whereby a franchisor grants a franchisee, *inter alia*, the right to develop the franchisor's network over a given territory (often another country or a group of countries). In this scenario, the master franchisee plays two roles. In the first, it performs as a franchisee of the parent network, whilst in the second, it assumes the role of franchisor vis-à-vis the franchisees it recruits to develop the network on its granted territory, imposing upon such franchisees, *mutatis mutandis*, the applicable provisions of its master franchise agreement with the master franchisor. Among the brands that operate master franchises are McDonald's®, Pizza Hut® and Pearle Vision®.

4.3. Legal Framework.

At the European level, the franchise is regulated only under its competition law aspects. Considering that the franchise model incites competition, the European Legislator decided to grant it the benefit of an exemption from regularly applicable competition law constraints, defining the conditions upon which a franchise agreement could benefit of this exemption regime. Having first adopted Regulation

(136) P. Kileste and C. Staudt, *Contrat de Franchise*, *op. cit*., p. 13.

(CEE) n° 4087/88, specific to franchise agreements, then exemption Regulation (CE) n° 2790/1999, today it is Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices that applies (137).

In Belgium, the franchise agreement is a *sui generis* agreement, and is not the object of specific legislation. According, the general common law rules with respect to contractual obligations apply (Articles 1101 to 1369 Civil Code), as well as the provisions concerning market practices (Book VI of the CEL) and competition law (Books IV.1 and IV.2 of the CEL).

As mentioned earlier in this presentation, since the entry into force of the Law of 19 December 2005 on pre-contractual information in connection with commercial partnership agreements, which now forms part of Title 2 of Book X of the CEL (Articles X.26 to X.34 of the CEL) (see *supra*, Section 2), only the pre-contractual phase of the franchise is regulated by Belgian law.

Furthermore, the question of the application to certain franchise agreements of the provisions relating to the unilateral termination of exclusive distribution agreements entered into for an indefinite term remains open (Articles X.35 to X.40 of the CEL) (see *supra*, Section 4.2).

Among the "soft law" rules applicable is the European Code of Ethics for Franchising (the "Code") that was adopted by the European Franchise Federation in 1972 (138). The Code constitutes a guide for best practices and usages in franchising. It enumerates certain rights and obligations of the parties and extols loyalty and good faith in their relationship. Since the Code has no autonomous legal force, nevertheless, once integrated into an agreement between the parties, the provisions of the Code included therein will become enforceable in accordance with Article 1134 of the Civil Code (139).

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(137) For a detailed analysis of the European regulation, see P. Kileste and C. Staudt, *Contrat de franchise*, *op. cit.,* p. 25 *et seq*.

(138) The Code is regularly updated. Its current version is dated 7 June 2016.

(139) Article 1134 of the Civil Code: "*Legally formed agreements become law for those having entered into them. They may only be revoked by mutual consent or for causes authorized by the law. They must be performed in good faith*".

4.4. Formation of the Franchise Agreement.

Pre-contractual information obligations under the CEL (140)

We have previously mentioned that only the pre-contractual phase of a franchise (and more generally commercial partnership agreements) is subject to specific Belgian legislation. Title 2 of Book X of the CEL seeks to ensure a balance in the commercial relationship resulting from a franchise agreement and imposes upon the prospective franchisor that it provide to franchisee, at least one month prior to the signature of an agreement, a draft agreement as well as a pre-contractual information document (the PID) (141).

Article X.30 of the CEL provides that the failure to respect such obligation is sanctioned by the nullity of the agreement which can be invoked for a period of up to 2 years following the signature of the agreement. Should the PID fail to include the important contractual provisions of the proposed agreement, then the franchisee may have such missing or incomplete provisions of its agreement invalidated.

Common law pre-contractual information obligations

Furthermore, other common law provisions may also apply to the pre-contractual phase of a franchise. For instance, Article 1134 of the Civil Code (142) that provides that agreements must be "*performed in good faith*". This imposes upon the parties from the outset a duty of loyalty and close collaboration which must last throughout the performance of the agreement. This establishes a general mutual obligation to provide pre-contractual information of such a nature and quality as to allow each party to properly evaluate the proposed venture, its proposed risks and opportunities in full knowledge of all relevant issues.

The failure to provide information (for example concerning the state of the franchise network, on market forecasts or investments required by the franchisee candidate) or providing incorrect information (for example providing an over-optimistic presentation of the know-how, the misrepresentation of or providing false or misleading information on the state of the franchise network, on market research or profitability) may result in an obligation of indemnification for breach of the pre-contractual information obligation (*culpa in contra-*

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(140) For further discussion, see *supra*, Section 2.

(141) Art. X.27 of the CEL.

(142) See *supra*, footnote 143.

hendo, Art. 1382 Civil Code) and/or the nullity of the agreement for default in consent (Art. 1110 *et seq*. Civil Code).

4.5. Performance of the Franchise Agreement.

As mentioned earlier, it is only the pre-contractual phase of the franchise that is regulated by Belgian law, so that the parties must include in their agreement all of the rights and obligations relating to the operation of the franchise. It is essential that their respective obligations be clearly described in the agreement, and as you will recall, such obligations must have been previously notified in the PID, exactly as they will appear in the franchise agreement (143).

4.5.1. The Parties' Obligations.

The following non-comprehensive list points out several of the most important obligations of the parties:

a) *Franchisor Obligations*

The franchisor must:

- make available to franchisee its know-how and intellectual property rights (for instance, in a franchise operating manual);
- maintain the know-how provided during the term of the agreement. The franchisor must maintain and renew its trade and service marks;
- offer franchisee continuous support, as much at the commercial level as with respect to technical and financial matters, throughout the life of the agreement;
- deliver to franchisee the products and/or services agreed upon in the agreement;
- maintain and update the franchise concept. However, unless otherwise agreed, the franchisor may not make any substantial changes to the franchise concept without the approval of the franchisee; and
- respect exclusivity granted (territorial or customer-based).

b) *Franchisee Obligations*

The franchisee must:

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(143) Article X.28, §1, 1° CEL.

• respect the franchise network norms, following franchisor instructions as to image and network identity;

• fulfill certain financial obligations such as:

— pay the franchise network entry fee,

— pay the royalties (represents consideration for availability and maintenance of know-how and continuous support),

— reach the minimum turnover imposed by the franchisor (could also be defined as a certain quantity of product or a level of market penetration),

— participate in the financing of franchisor's network advertising campaigns;

• safeguard and maintain the confidentiality of franchisor know-how;

• commercialise the products or services as per franchisor instructions;

• finance its operations, including rental of premises, shopfitting, recruit staff, maintain inventory, support advertising costs, etc.

As a reminder, the obligations imposed upon the franchisee must not compromise its independence, for fear of the risk of requalification of the agreement as an employment agreement.

4.5.2. Non-compete Clauses.

The parties may include a non-compete clause in their agreement, prohibiting the franchisee from competing with its franchise activities during the term of the franchise agreement. Of course, such non-compete clause must have been previously correctly notified in the PID.

Such a clause will be admissible in European law when it is necessary to preserve the common identity and reputation of the franchise network (144). Moreover, it may benefit from the EU Vertical Agreements Block Exemption Regulation if the individual market share of each party is less than 30% and the clause applies for a period of less than 5 years (145).

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(144) European Commission Notice "Guidelines on Vertical Restraints", pt. 190, b).

(145) Art. 5,1 Commission Regulation (EU) n° 330/2010.

A non-compete clause that is tacitly renewable is deemed for an indefinite period and cannot benefit from the exemption regulation. If such a clause forms part of an

Under Belgian law, a non-compete clause is valid as long as it is limited in time, scope and as to its object.

4.6. Term and Termination of the Agreement and Indemnities upon Termination.

The CEL does not contain specific provisions pertaining to the minimum term of the agreement, the termination notice or the indemnity to be paid for increase in client base, leaving these issues to be agreed upon by the parties, failing which, the general common law rules shall apply.

4.6.1. Term.

Since there is no specific legislation in this respect, the parties may freely choose the term of their agreement.

Most franchise agreements are for a fixed term, and considering the investments made by the parties (search for a serious partner, training of candidates, network integration, etc.), they usually underlie a long-term partnership.

As to the duration of the agreement (generally between 5 and 10 years depending on the sector of activity (146)), the parties will consider several factors, such as the time needed for the franchisee to recover the amounts invested to ensure its operations respect the franchise network norms and concept (147). If the franchisee plans to operate out of leased premises, it may also be convenient to match the franchise agreement term to the term of the lease, especially in cases where the term of the lease is subject to specific legislation. For instance, in Belgium, a lease

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agreement longer than 5 years in duration, then the clause must specify that it no longer remains in effect after 5 years and may only be renewed by consent of the parties.

The time limitation of five years shall not apply where the contract goods or services are sold by the buyer from premises and land owned by the supplier or leased by the supplier from third parties not connected with the buyer, provided that the duration of the non-compete obligation does not exceed the period of occupancy of the premises and land by the buyer (Art. 5,2 Commission Regulation (EU) n° 330/2010).

In such cases, the non-compete clause may apply for as long as the term of use of the premises and land by the buyer.

(146) P. Kileste and C. Staudt, *Contrat de franchise*, *op. cit*., p. 184.

(147) See Article 5,3 of the European Code of Ethics for Franchising.

Bear in mind that certain credit facilities may require that the franchise agreement have a duration at least equal to that of the credit facility.

must have a term of at least 9 years and offer the lessee the possibility to terminate upon at least 6 months' notice every three years.

Also in determining the term of the agreement it is important to take into consideration Belgian and European Competition Law which impose limitations on the duration of certain obligations, such as for exclusive supply arrangements and non-compete provisions.

Finally, it will be important to include in the agreement the terms and conditions relating to the renewal of the agreement, since these are important contractual provisions within the scope of Article X.28 of the CEL, they must appear in the PID.

4.6.2. End of the Agreement.

As pointed out previously, since the franchise agreement is a *sui generis* agreement, it is not regulated in any specific legal terms, except for its pre-contractual phase. Consequently, the termination of the franchise agreement follows the general applicable common law principles and the legal effects of the termination of the franchise relationship will depend upon whether the agreement is for a fixed or indefinite term.

Also as previously stated (see *supra*, Section 4.2), the doctrine (148) and case law (149) are quite divided as to the application of the protective provisions of Title 3 of Book X of the CEL with respect to the unilateral termination of exclusive distribution agreements entered into for an indefinite term to the termination of distribution franchise agreements. The court must determine, *in concreto*, on a case by case basis, whether the respective obligations of the parties result from a franchise agreement or a distribution agreement, without regard to the

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(148) For a more complete examination, see P. Kileste and C. Staudt, *De l'application de la loi du 17 juillet 1961 à un contrat de franchise ou les véhicules hybrides échappent-ils au code de la route?*, *J.L.M.B.*, 2011, p. 1013; P. Kileste and C. Staudt, *Contrat de franchise*, *op. cit.*, p. 125 *et seq.*; P. Demolin and V. Demolin, *Le contrat de franchise. Les règles juridiques applicables au contrat de franchise en Belgique. Analyse et commentaire de quinze années de jurisprudence 1995-2010,* Larcier, 2011, p. 57 *et seq.*

(149) In favour of application, see, *inter alia*, Gand, 12 October 1994, *R.D.C.*, 1919, p. 501; Comm. Liège, 15 September 1995, *J.L.M.B.*, 1997, p. 1658; Liège, 19 March 1998, *R.D.C.*, 1999, p. 278; Against application, see, *inter alia*, Bruxelles, 11 April 1997, *R.D.C.,* 1999, p. 264; Liège, 19 March 1998, *D.A.O.R.*, 1999, liv. 48, p. 79; Anvers, 20 September 2004, *R.D.C.,* 2007, p. 172; Mons, 26 April 2007, *R.D.C.*, 2007, p. 1024; Liège, 9 January 2009, *J.L.M.B.,* 2011, liv. 11, p. 1010.

qualification made by the parties. For an analysis of Articles X.35-X.40 of Title 3 of Book X of the CEL, we refer the reader to Section 3.4.3 of this presentation.

The rules applicable to the termination of a franchise agreement as well as the consequences of such termination for the parties differ depending upon whether the common law provisions with respect to obligations or the provisions of Title 3 of Book X of the CEL apply.

We will limit ourselves to a brief overview of the termination of franchise agreements under general common law principles (150). For the classic causes of extinction of obligations, such as judicial resolution, immediate termination for serious fault and the occurrence of a resolutory condition, please see *supra*, Section 3.4.3

4.6.2.1. Fixed Term Franchise Agreements.

A fixed term franchise agreement will terminate naturally at the end of its agreed term.

The franchisee has no claim to renewal of the expired agreement and the franchisor may refuse to renew the agreement and thereafter enter into an agreement with another franchisee. Franchisor may also propose a new agreement with same franchisee, but on less advantageous terms. Apart from a few exceptions, this refusal to renew the agreement at its term is not considered an abuse of rights but rather the right to not agree.

The parties may however include in their franchise agreement a clause to continue or extend the agreement beyond its initial term, in which case the agreement will survive.

In the absence of such a clause, should the parties continue their performance of the agreement beyond its term, then a refutable presumption is created that a new agreement has been agreed for an indefinite term.

It is also possible under general contract law that the parties agree to terminate their relationship before it has run its course.

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(150) In this presentation, we do not discuss the causes of nullity of the franchise agreement (for violation of the provisions of Title 2 of Book X of the CEL with respect to pre-contractual information or for a default in consent), nor the *intuitu personae* nature of the franchise agreement which would allow for termination of the agreement upon the death of the franchisee or of the principal representative of a corporate franchisee.

Should a franchisor prematurely terminate its agreement with a franchisee without establishing that this was for a serious fault of the franchisee, the courts will award franchisee an indemnity to compensate for losses suffered, including for lost revenue, from the time of such premature termination. In assessing this indemnity, the courts will generally take into consideration the net profits of the business increased by any incompressible costs (151).

Finally the parties may wish to include in their agreement a renunciation clause or waiver whereby upon the payment of a fixed amount to the other party, a party may terminate the agreement before its term. The payment of such amount does not result from a party's fault or breach of the agreement, as opposed to a penalty clause, and it appears that the courts have no discretion as to its amount (152).

4.6.2.2. Franchise Agreements of Indefinite Term.

Franchise agreements are generally entered into for a fixed term. Nevertheless, the parties may choose to enter into such agreement for an indefinite period of time. This often occurs in situations where, from the outset, franchisor and franchisee wish to establish a long-lasting relationship, the term of which is difficult to establish, or in situations where a fixed term agreement has been extended beyond its initial term (which is often the case).

In cases where a franchise agreement is concluded without a fixed term, either the franchisor or the franchisee may terminate the agreement unilaterally at any time, insofar as reasonable notice is given and that the termination is not considered an abuse of rights (153). This right to terminate unilaterally finds its justification in the principle which prohibits perpetual commitments and that of sustaining competitive markets.

Such unilateral termination may occur only following the giving of the notice that was agreed-upon by the parties in their agreement; if the parties have failed to agree upon such notice, then the notice period given must be reasonable and respect the principle of good faith.

Contested, the reasonableness of the notice will be assessed by the

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(151) Liège, 19 March 1998, *D.A.O.R.*, 1999, liv. 48, p. 79 and comments of P. Demolin and V. Demolin, *op. cit*., p. 87 *et seq*.

(152) Cass., 22 October 1999*, J.L.M.B*., 2000, p. 476.

(153) Bruxelles, 19 May 1998, D.A.O.R., 1999, liv. 48, p. 93.

court at its discretion taking into account the length and financial importance of the relation between of the parties, the costs and investments made by the franchisee, as well as the amortization of such costs, the brand recognition and the time required for the franchisee to find business activities with equivalent advantages (154) .

If the court concludes that the notice did not comply with the reasonable notice obligation, the termination will be deemed unlawful and the aggrieved party, often the franchisee, will be entitled to damages, to compensate for the abrupt termination. In its discretionary assessment, the court will appreciate the prejudice *in concreto*, taking into account the circumstances on a case by case basis.

Notable too is the fact that as long as it respects the conditions agreed in the agreement, a franchisor is not obligated to explain its decision to terminate the agreement (155).

4.6.3. Are Goodwill Indemnities due upon Termination?

The common law applicable to obligations does not provide for the payment to the franchisee of an indemnity for eviction or goodwill. The doctrine considers that the franchisor benefits from the attractiveness of the network — and consequently of the goodwill gained from the common efforts of franchisor and franchisee — throughout the term of the agreement to operate its business and to derive profits therefrom. Thusly, the contribution to and/or development of the client base for the benefit of the franchisor finds its "*counterpart in the economic advantages that benefited the franchisee during the term of the agreement*" (156).

In the absence of the conditions required to claim damages under a "pure" common law action for damages, a franchisee who considers itself entitled to a goodwill indemnity could attempt to recover same by requalifying its agreement as a distribution agreement, with however, all the difficulties that this entails.

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(154) S. Willemart, *Analyse comparée des mécanismes et questions d'actualité posées par l'indemnité de clientèle en matière de concession de vente, per l'indemnité d'éviction en matière d'agence commerciale et par le droit commun en matière de franchise*, in *Regards croisés sur la distribution: concession, agence et franchise*, Larcier, 2015, p. 94 *et seq*.; P. Demolin and V. Demolin*, op. cit.,* p. 84.

(155) Bruxelles, 11 April 1999, *R.D.C.*, 1999, p. 264.

(156) S. Willemart, *op. cit.,* p. 95 *et seq*.

4.7. Post-contractual Obligations: Removal of Distinctive Signs, Return of Inventory, Non-compete.

Many obligations may be incumbent upon the parties following the termination of their franchise relationship.

We will examine the most common of such obligations which most often fall upon the franchisee.

4.7.1. Obligation to Remove all Distinctive Signs which refer to the Franchisor Brand or its Network.

The franchisee must remove all references to the franchisor network (for example, store brand) and return all items distinctive of the network, such as commercial and promotional documents and know-how support material (for example, the franchise operating manual). The franchise agreement will often include a penalty payable for each day that the franchisee is in default of complying with these obligations.

The franchisee must also comply with the provisions of Book V of the CEL which prohibit unfair commercial practices (157), in that the franchisee must avoid taking any action which could be considered unfair competition by creating confusion in the eyes of the public. The use of distinctive signs similar to those of the brand which would suggest being part of an official network for such brand could constitute false and misleading advertising and a source of confusion (158). On the other hand, it was held that a franchisor may not stake a claim to any protection for the concept that it developed (whereby the importance of confidentiality obligations become critical). Only the flagrant copy of part or all of the essential elements of a franchise, concrete and verifiable, that translate the originality of the know-how and its commercial strategy may be punishable, should it be established that they lead to confusion of the public as to affiliation with the ex-franchised network or damages the network's image and integrity (159).

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(157) Art. VI.104 CEL: "Is prohibited any action contrary to honest market practices by which an enterprise undermines or could undermine the professional interests of one or many other enterprises".

(158) Comm. Bruxelles, 23 April 2010, *I.R.D.I.*, 2010, p. 435.

(159) Bruxelles, 23 January 2004, *R.D.C.*, 2005, p. 942. For an analysis of the jurisprudence, see P. Demolin and V. Demolin, *op. cit.*, p. 116 *et seq*.

4.7.2. Return of the Inventory.

No legal provision covers what happens to the remaining inventory following termination of the franchise agreement. Consequently, it is in the best interests that the parties include the proper provisions in their agreement in order to avoid this sensitive issue. On one hand, the franchisee will not have the capacity to liquidate the inventory on the same terms it benefited during the franchise term (loss of use of brand and distinctive signs, possible end of lease of premises for point of sale, etc.), while on the other, the franchisor's interests are best served with the sale of its products within the protected framework of its network (pricing conditions, brand image, etc.).

Given the lack of case law on this matter, the doctrine (160) tends to apply the principles set by the jurisprudence in cases concerning the termination of distribution agreements (161). Hence, it is generally admitted that, in application of the principle of good faith in the performance of agreements, the franchisor must accept the return of unsold inventory and pay a fair price therefor, except in situations where the termination is for a fault of the franchisee or the products are stale-dated or unfit for sale as at the termination date of the agreement (for example, food perishables) (see *supra*, Section 3.5).

In cases where a franchise agreement is nullified (162) or terminated by resolution, the obligation of reciprocal restitution implies that the franchisor must accept the return of the inventory and reimburse the franchisee for any inventory that has been paid for (163).

4.7.3. Non-compete and Post-contractual Affiliation Clauses.

As expected, a great majority of franchise agreements contain a non-compete clause or an affiliation clause.

A post-contractual non-compete clause prohibits the franchisee from pursuing commercial activities that compete with those of the franchisor following the termination of the franchise agreement, whilst an *affiliation clause* prohibits the franchisee from joining a competing

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(160) Notably, P. Kileste and C. Staudt, *Contrat de franchise*, *op. cit*., p. 192; P. Demolin and V. Demolin, *op.cit*., p. 142 *et seq*.

(161) Cass. 31 October 1997, *R.D.C.,* 1998, p. 228.

(162) For example, in case of the failure to conform to the pre-contractual information provisions of Title 2 of Book X of the CLE.

(163) Comm. Liège, 14 May 2009, *D.A.O.R*., 2009, p. 388.

distribution network, although the franchisee may itself independently pursue competing activities.

Both these clauses are generally viewed as submitted to conditions similar to those amply discussed *supra*, Section 3.6, as to their validity.

It seems also important to remind the reader that Article 5.3 of Regulation (EU) n° 330/2010 allows for the parties to include within their franchise agreement a clause imposing a restriction which is unlimited in time on the use and disclosure by franchisee of franchisor know-how which has not yet entered the public domain.

Chapter IV

TERMINATION OF FRANCHISING AND DISTRIBUTION AGREEMENTS IN GERMANY

by *Robert Budde* (*)

1. Introduction.

Despite their growing economic importance, neither franchise agreements nor distributorship agreements are regulated by statutory law. Legal commentary, case law and the use of contracts in practice have, however, established a system in which both contracting parties are embedded in existing statutory regulations. These two types of contracts and their legal aspects have many common features. For this reason, an attempt is made in this presentation to focus on the common elements of the two types of contracts.

In legal commentary, the traditional franchising form, subordination franchising, is also described as "the further development of the distributorship model". Many common features arise from this further development, but important differences have also evolved. Because of their similarity, it is difficult in some cases to differentiate between the types of contracts; there are overlaps. Moreover, many issues regarding the application of legal principles and standards have come up as a result of the common elements.

(*) *Lawyer in Germany, Dusseldorf - robert.budde@cms-hs.com*

1.1. Common elements.

Franchise agreements and distributorship agreements are typically framework agreements. They regulate the relationship between a franchisor or (in the event of a distributorship agreement) a manufacturer or intermediate distributor (hereinafter: supplier) and the franchisee or distributor (hereinafter: dealer). It is characteristic of these agreements that the dealer acts on its own behalf and for its own account in the interests of the supplier. This is the difference between a dealer and a commercial agent. A commercial agent acts on behalf of a third party and for the account of a third party; a commercial agent arranges offers by the supplier and in doing so increases the supplier's sales. This is thus a vertical and cooperative form of distribution. The dealer is integrated in the supplier's distribution network — to a greater or lesser degree, depending on the form.

Both parties remain legally independent entities, however, even if this may not be recognisable from the outside. This also means that each party bears its own economic risk. In addition, a continuing obligation between the parties is established by the framework agreement. This relationship is characterised by a close and long-term cooperation. In their working relationship, the parties are economically dependent on one another. In the majority of the cases, this dependence is more perceptible for the dealer. The dealer's partner, the supplier, is often a major market player and has more financial resources than the dealer. Besides, increased duties to act in good faith towards the respective other contracting party arise from the continuing obligation.

The increased duties to act in good faith are noticeable with respect to the (pre-contractual) duties of disclosure regarding the conclusion of a franchise or distributorship agreement. Both parties have an interest in finding out whether the respective other party will contribute a financially profitable concept to the contractual relationship. In principle, potential contracting parties must disclose to one another any and all circumstances that are significant for the conclusion of the contract. A breach of this duty can lead to an obligation to provide compensation.

It is frequently the case, however, that the supplier has more information about the distribution system. For example, the supplier has many years of experience with a sales concept, and data and statistics in this respect are available to it. In particular, the supplier can

produce profitability calculations for its distribution system that the potential dealer cannot carry out in this manner. As a result, there are different levels of information to the detriment of the dealer. Because — as stated — there are increased duties to act in good faith under franchise and distributorship agreements, the supplier is obligated to counter these different levels of information.

These disclosure duties are stronger under a franchise agreement than under a distributorship agreement. Franchisees must be informed correctly and fully of circumstances that are decisive for the contract. This includes the supplier's profitability calculation. The supplier may not describe a system as more successful than it actually is prior to the conclusion of an agreement. This principle is also laid down in the (non-binding) codes of ethics of the European and German franchising associations. Franchisees are frequently business start-ups. They have no market experience at all and need sufficient information for their launch on the market and the assessment of their entrepreneurial risk. This may not lead to excessive expectations regarding the disclosure duties, however. A residual risk remains, and the disclosure duty does not warrant the profitability of a distribution model.

There are also common elements with respect to the legal classification of the two types of contracts. They themselves are not regulated by statutory law, but they are — depending on their form — classified as similar, existing contract types. In both cases, these are mixed-type contracts. This means that the contracts consist of different elements of contract types that are regulated by statutory law. They both have elements of a contract for work and services, purchase contracts and contracts for the services of an agent. According to the prevailing view, the emphasis is on the contract for the services of an agent (§§ 675ff. of the German Civil Code (*BGB*)). A dealer acts independently and at its own risk in the interests of the supplier. Likewise, the legal classification also offers a possibility to differentiate between the two types of contracts.

With regard to the two types of contracts, the question arises as to whether the rules for a commercial agent (§§ 84ff. of the German Commercial Code (*HGB*)) apply *mutatis mutandis*. This is affirmed almost unanimously for distributorship agreements, at least when the distributor is integrated in the supplier's distributorship system in a manner that is comparable to a commercial agent. This is more of a problem for a franchise agreement, especially considering that fewer court rulings regarding such cases have been rendered. Among other

things, the termination of commercial agency relationships and their post-contractual wind-up are regulated under §§ 84ff. of the Commercial Code. The second part of the presentation (II) will focus on this and the analogous applicability of the rules concerning commercial agency relationships to franchise and distributorship agreements.

1.2. Particularities.

a) Franchise agreement

Franchise agreements are characterised by their many particularities. In franchising systems for the distribution of goods and services, there is often hardly any difference between the external appearance of the point of sale of a stationary franchisee and that of a retail branch of the franchisor. A typical feature of a franchise system is the franchisee's outlet-like appearance. The franchisor awards the franchise, which includes the right to use trademarks and other symbols, support of the franchisee and protection against competitors, to the franchisee. The right to use a trade mark, logo, name or symbol protected for the benefit of the franchisor makes it possible for franchisees to have a uniform appearance. In addition, many franchising systems are designed to involve a great number of franchisees. In all, this results in a uniform appearance of the franchisees.

The main feature of a franchising system is the granting of rights to use the franchisor's intellectual property rights such as trademarks, patents, registered designs, rights of use and know-how. The franchisee can thus be systematically involved in the franchisor's distribution structure. The offers that are typical for the franchisor can also be distributed/sold by several franchisees. Moreover, the training sessions conducted by the franchisor warrant the desired appearance and conduct of its franchisees. All in all, the impression of a "quasi-outlet" is thus given.

Altogether, franchising has great economic advantages for both contracting parties. For the franchisee, franchising can mean a simple launch. As a rule, the provision of rights of use and know-how is a great advantage for the franchisee, especially when the franchisee is a business start-up. Franchisees can profit from a system that has been tested on the market without taking a great risk and implementing extensive measures. Franchisors have economic advantages because of the outsourcing of distribution. They do not have to create their own sales organisations, their capital investment is limited in comparison to a

system of branches of their own, and due to the franchise fees they have a secure source of income.

Another typical feature of a franchise system that distinguishes it from distributions via a distributor is the payment of franchise fees owed by the franchisees for the benefits provided to them. This is usually a one-time payment plus a regular utilisation fee.

There are different franchising systems: subordination franchising, partnership franchising and master franchising. Subordination franchising is the "classic" franchising form. It is — as stated above — to be considered a further development of the distributorship model. Subordination franchising is distinguished by the hierarchical relationship between the involved parties. It is also characterised by a strong integration of the franchisees in the franchisors' systems. Franchisees are often strictly bound to follow the instructions of and satisfy the standards imposed by the franchisors. In this presentation, where "franchising" in general is discussed, subordination franchising is the point of reference. This is the typical form of systematic franchising.

Partnership franchising is characterised by the equal status of the franchising partners. They are on the same commercial level and work together as more or less partners. Partnership franchising is thus an equal-level franchise system.

In master franchising, the master franchisee is granted the right to award sub-licences to other franchisees. These sub-licences are usually subordination franchising agreements. Master franchising is thus a multi-level franchise system.

b) Distributorship agreement

Under distributorship agreements, dealers are obligated to sell the suppliers' products to the best of their ability; in return, the dealers are granted special purchase terms by the suppliers that ultimately make a profitable sale to the next level of trade possible. Distributorship agreements are characterised by a looser involvement of the dealers in the suppliers' distributorship systems than under franchise agreements. Like in franchising, the dealers may often use the suppliers' logos and trademarks. These are usually placed only next to the names of the dealers' companies, however. The dealers' independent position vis-à-vis the suppliers is often emphasised by the fact that — unless the parties have agreed otherwise — competitors' products may also be sold, and the distributors are thus not limited to only one brand. Whether a distributor may offer several manufacturers' competing

products in one line next to one another or non-competition is agreed on differs greatly from sector to sector. Distributors also often assume the obligation to set up a customer service system. This includes, for relevant products, replacement parts and equipment and tools for installing the replacement parts.

Distributors must promote the sale of their suppliers' products. One element of this duty is the distributors' duty to inform the suppliers of the current situation and the development of the market for the product. The suppliers, if they are also the manufacturers, can then adapt their products to make them more attractive for the market. A minimum purchase obligation for distributors can also be set out in the distributorship agreements. This also causes the suppliers' sales to be increased and kept on a certain level.

This duty of distributors to promote sales is accompanied by the suppliers' obligation to supply the distributors with the contract products. Unless otherwise agreed, the suppliers are thus not at liberty to accept or refuse the distributors' orders. Within the framework of their ability to deliver, the suppliers are obligated to conclude binding purchase agreements.

Distributors can also be granted contractual benefits in return for the obligations. This includes, for example, exclusive distribution rights. This means that a distributor may be the only distributor of the contract products in a specified territory. There are two types of exclusive distribution. In the weaker form, the suppliers are obligated only not to use any other dealers or other types of distribution partners (e.g. commercial agents). In the stronger form of exclusive distribution, the suppliers may also not make direct deliveries to customers in the contractual territory.

All of this shows that there can be an intensive relationship between a distributor and a manufacturer.

1.3. Differentiation.

It can sometimes be difficult to differentiate between the two types of contracts. Distributorship agreements can often include elements of franchise agreements. Franchise agreements and distributorship agreements often overlap as a result of a combination of different elements typical for one or the other type of contract. This becomes very clear when one sees franchising as a further development of distributorship agreements. Overlaps thus appear to be natural. The particularities of

the respective type of contract and specific differences between the two legal institutions make differentiation possible, however.

This becomes clear, for example, when one considers franchising with respect to goods and services. Goods can be distributed by way of both systems. These are then goods franchising and goods distribution by a distributor. In this area, the two forms of distribution can be almost identical. A franchise system is often the more suitable form of distribution of services, however. Franchising of services is thus often referred to as the "pure form of franchising".

The above-mentioned particularities also make a distinction possible. This applies particularly to the franchise fee. This is typical for franchising and does not appear in distributorship agreements; it is thus a clear criterion for differentiation. It should be mentioned that the two contract types are treated equally in many points and that a precise determination of the contract type is irrelevant in many cases.

2. Termination and Post-Contractual Wind-Up of Distributorship and Franchise Agreements.

2.1. Termination.

a) General

The termination of a franchise or distributorship agreement depends generally on what the parties agreed. Their intentions are set out in the agreement, and private autonomy is manifested here in the form of contractual freedom. This is limited in part by statutory law — in order to protect one of the contracting parties. This applies particularly to the end of the agreement; notice periods are primarily supposed to protect the weaker contracting party.

There are different options for termination. In particular, these are: termination agreements and the expiry of fixed-term contracts, as well as terminations for convenience and terminations without notice for cause. In practice, termination agreements and expired contracts seldom harbour problems with regard to termination, so they will be explained only briefly.

b) Termination agreements and passage of time

Termination agreements result from contractual freedom. A termination agreement can in principle be concluded informally unless

prevented by mandatory laws such as § 311b (1) of the Civil Code. It is advisable to specify the payment entitlements and any post-contractual claims, such as a non-compete covenant, already in the termination agreement.

A fixed contract term can also be agreed on from the outset in distributorship and franchise agreements. When the fixed term ends, the agreement also terminates due to the passage of time. No notice of termination has to be given.

c) Termination for convenience

Both contract types, franchise agreements and distributorship agreements, can be terminated for convenience (with a notice period). This applies primarily to contracts without a fixed term (permanent contracts). Fixed-term contracts are usually to be interpreted to mean that a right to terminate for convenience (with a notice period) is supposed to be excluded. It seldom occurs that the parties explicitly agree on a right to terminate for convenience (with a notice period) when the contract has a fixed term. There is no other prerequisite for a termination for convenience. No reason must be given either. If no special form for termination is stipulated in the agreement, termination may be declared orally or even by way of implicit conduct. It is advisable, however, for reasons of evidence, to give notice of termination in writing; in such cases, transmission by fax or e-mail suffices. If a specific form for termination is stipulated in the agreement, it is a question of interpretation whether compliance with the form is essential for the validity of the termination.

Both of these contract types lack provisions regarding termination for convenience. It is possible to apply § 89 of the Commercial Code *mutatis mutandis*. This section regulates the termination of commercial agency contracts for convenience. In paragraph (1), notice periods for contracts of indefinite duration are specified:

- During the first year of the contractual relationship — notice period of one month
- During the second year of the contractual relationship — notice period of two months
- In the third to fifth years of the contractual relationship — notice period of three months
- After five years — notice period of six months

in each case, effective at the end of a month.

According to the prevailing opinion, § 89 of the Commercial Code

should be applicable *mutatis mutandis* to both contract types. This is suggested by both legal commentary and the rulings of the higher courts. Their rationale is based on the assumption that § 89 of the Commercial Code is a regulation for the protection of commercial agents. Commercial agents are therefore integrated in the suppliers' distribution systems to such an extent that their position is weaker than the suppliers'. The same applies to distributors and franchisees; they are also often very closely involved in the supplier's distribution system. This is also suggested by the fact that suppliers and dealers are supposed to have time to bring their ongoing operations to an end or to reorganise them; the suppliers are also supposed to be able to look for new business associates.

The analogous application of § 89 of the Commercial Code to distributorship and franchise agreements has two consequences: If an agreement concluded for an indefinite duration does not contain any notice periods, the above-mentioned notice periods provided for under § 89 of the Commercial Code apply. If, however, the parties have agreed on notice periods in a contract, these are invalid if they are shorter than those provided for under § 89 of the Commercial Code, because those are minimum periods under mandatory law that cannot be shortened.

In the period between the declaration of termination for convenience and the end of the notice period, contractual relationships remain valid, including all rights and duties. Dealer thus continue to be obligated to sell the contract products to the best of their ability, and suppliers continue to be obligated to supply the dealers with contract products. The suppliers are not entitled, in particular, to terminate the contractual relationships factually with immediate effect and to pay the dealers compensation for the time of the notice period. Such an early termination of the contract can be agreed on by the parties only by mutual consent. The suppliers' obligations to deliver are limited, however: they must deliver to the dealers only that number of products that the dealers need, based on the usual course of business to be expected, to be able to continue their distribution operations properly until the end of the contract. Suppliers are not obligated, in particular, to deliver so many products to the dealers that the dealers still have considerable stocks at the end of the notice period.

d) Termination for cause (without notice)

Both contract types may be terminated without notice for cause.

This applies to cases in which one contracting party wishes to separate from the other contracting party before the expiry of the contractual term or before the end of the notice period. Owing to the far-reaching — sometimes existence-threatening — consequences of termination without notice for the contracting parties, a termination for cause without notice is always permissible only as the last resort — *ultima ratio*. This is generally acknowledged in legal commentary and court rulings. This principle has its legal manifestation in § 314 (2) sentence 1 of the Civil Code. If the good cause (compelling reason) for the termination without notice is a breach of contract, a prerequisite for the termination is that "the contract may be terminated only after the expiry without result of a period specified for relief or after a warning notice without result". This means that the other party must first be given an opportunity to remedy its faulty performance or to return to proper contractual behaviour. Only if the breach of contract is so grievous that the terminating party cannot reasonably be expected to give such a warning notice can this be waived. This is usually the case only where there have been gross breaches of the relationship of trust.

The aforementioned provision under § 314 of the Civil Code generally regulates the prerequisites for a termination of continuing obligations for a compelling reason. Because franchise and distributorship agreements are continuing obligations, § 314 is considered applicable in most cases.

Moreover, the analogous application of § 89a of the Commercial Code (which applies to commercial agency agreements) is generally acknowledged and is discussed also for franchise agreements. This rule, too, says essentially that a contractual relationship can be terminated at any time without the observance of a notice period for an important reason and that this right cannot be excluded or limited. In the end, the regulations are very similar, so it is usually irrelevant which one is cited.

This applies to both laws: They cannot be waived by contract, but are mandatory. This is explicitly stated with respect to § 89a of the Commercial Code in subparagraph 1, sentence 2; for § 314 of the Civil Code, this results from a generally acknowledged legal principle.

2.1.1. Compelling or important reason.

The laws share an important prerequisite for termination, the "compelling or important reason" (good cause). Although a "compel-

ling or important reason" is mentioned in two different statutory laws, the prerequisites are largely the same.

There is a "compelling or important reason" if the terminating party, taking into account all the circumstances of the specific case and weighing the interests of both parties, cannot reasonably be expected to continue the contractual relationship until the agreed end or until the expiry of a notice period (see § 314 (1) sentence 2 of the Civil Code). This means that whether a "compelling or important" reason exists depends on the salient circumstances of the individual case, and a comprehensive assessment of the particularities of the agreement must be carried out. This includes, for example:

- the details of the contractual relationship (for example, grounds for termination stipulated in the agreement),
- the severity of the breach of contract,
- the previous and planned duration of the cooperation,
- investments made by the parties,
- personal and objective relationship between the contracting parties.

With respect to the review of whether there is a compelling or important reason that justifies termination without notice, the question in the foreground is whether the terminating party can reasonably be expected to continue the contractual relationship until the next possible date for termination with notice (for convenience) or not.

The compelling or important reason consists in many cases of a breach of contractual duties that can sometimes lead to a breakdown of the relationship of trust. A frequent case of a severe breach of contractual duties that can lead to a loss of trust is, for example, a dealer's breach of a contractual non-compete covenant or an infringement of the contractual right of exclusivity warranted by a supplier.

For a termination without notice, however, it is not necessary that the breach of contract is based on a fault of the recipient of the notification of termination (even if this is often the case). A compelling or important reason can also be found within the terminating party's sphere of influence, for example, when a subsidiary that is the other contracting party in a contract with the dealer must discontinue the distribution of the contract products because the parent company no longer supplies them. On the dealer's side, for example, an accident that makes it impossible for the dealer to continue its work for the supplier can justify the immediate termination of the contractual relationship.

In all, a compelling or important reason can result from many circumstances. The circumstances of the individual case must be taken into consideration for an assessment. Some "compelling or important reasons" that can lead to terminations without notice are named here as examples:

- insolvency of one of the contracting parties,
- breach of confidentiality duties,
- breach of the duty to promote sales and a severe decline in sales,
- breach of a non-compete covenant,
- reduction of the dealer's contractual sales territory by the supplier,
- breach of territorial protection by the supplier.

2.1.2. Special case: termination due to the other contracting party's economic failure.

In this section, a frequent case of a compelling or important reason for termination is supposed to be examined in detail: the other contracting party's economic failure. In most cases, it is the suppler who wants to separate from the dealer. The supplier usually has clear ideas about what sales the dealer must achieve so that the distribution is economically feasible. A long contractual term in conjunction with a distribution that is not economically feasible quickly results in financial disadvantages for the supplier. The sales expected by suppliers are in some cases set out in contract clauses concerning minimum sales to be achieved.

In practice, three constellations that lead to a termination of contract due to non-realised sales expectations occur most frequently: the first one concerns contracts without any agreement on a sales target. Second, although the contract may include an agreement on a sales target, it does not explicitly regulate what consequence is supposed to result from a failure to achieve the target. Third, there are contracts that include an agreement on a sales target and the consequences of a failure to achieve the target.

Moreover, a distinction must be made between provisions in individual contracts and provisions in general terms and conditions, because under German law a clause to the detriment of the other contracting party can be invalid, even if the agreement is concluded between two companies. A clause concerning minimum sales in general

terms and conditions, for example, might be invalid due to a violation of § 307 of the Civil Code.

If there are no contractual regulations, it must be examined whether a lower sales figure already constitutes a breach of a contractual duty. In a first step, it must be determined whether there has been a failure to achieve the owed sales figure that is the dealer's fault. To be able to make statements about this, a basis for comparison is needed. Such a basis for comparison can be that more sales were made in the same territory in previous years (decline in sales), or that other comparable dealers made more sales in comparable contractual territories. A decline in sales is frequently the reason for considering termination without notice. The decline must also be severe; slight fluctuations are not sufficient.

In a second step, it must be examined whether the failure to achieve the possible sales constitutes a breach of duty by the dealer. Dealers are obligated to promote sales. The question is thus whether this obligation was not met, whether the dealer could have put more effort into achieving more sales. The duty is breached when dealers can be accused of acting with gross negligence and permanent neglect in failing to promote sales and thus seriously failed to perform their duties. This evidence is often difficult for a supplier to provide.

If the agreement explicitly provides only for the duty to achieve a specific sales figure, but it remains open what consequences result from a shortfall, the agreement must be interpreted. First, the agreement must be interpreted with respect to a failure to achieve the agreed turnover in itself in order to determine what this consists of. It can be the case that the agreement was not intended to have any mandatory character at all. In a next step, it must be interpreted whether the failure to achieve the agreed turnover was supposed to entitle the supplier to an early termination of the agreement. It must be clear enough, on the basis of the agreement, that the achievement of the turnover constitutes a contractual duty of the dealer's. If this is the case, the supplier must still prove that the dealer culpably breached the duty. The supplier will be entitled to terminate the agreement without notice, however, only if the amount by which the minimum turnover was not achieved is significant. The following applies also in this case: Slight and temporary sales fluctuations are not sufficient for termination without notice.

If the parties do not stipulate in the agreement only that specific minimum sales must be achieved, but also that the supplier is supposed

to be entitled to terminate the agreement without notice in the event of a failure to achieve the targeted sales, this is initially a manifestation of private autonomy. The contracting parties may design their agreement as they see fit. This includes grounds for termination. This can, under certain circumstances, be interpreted to mean that the parties dispense with a weighting of interests and a review of whether it can no longer reasonably be expected of the supplier to adhere to the agreement. The limit of what is permissible is based, however, on the principle of good faith (§ 242 of the Civil Code). In line with the decisions rendered by the Federal Court of Justice, judgment of 7 July 1988 - I ZR 78/87 and judgment of 10 November 2010 - VIII ZR 327/09, it must be heeded that although the parties can in principle exclude the review of unreasonableness, this exclusion can still be reviewed as to whether it is proportionate.

Where such provisions are used by suppliers in general terms and conditions, thus — for example — in standard (boilerplate) contracts, the courts apply very strict criteria for their validity. The clause must then, for example, provide explicitly that a termination without notice is permissible only if the shortfall is substantial and the dealer is at fault for this. In such case, the parties may also not waive the requirement of a prior warning.

2.1.3. Form and deadline for termination without notice.

Termination without notice can in principle also be declared orally. For reasons of evidence, however, a written notification is advisable. The reason for the termination does not have to be communicated to the recipient of the notification. Usually, however, a dispute about the justification for the termination without notice arises, so it is advisable to communicate the reasons for the termination at least at a later time.

Moreover, the notification of the termination must, according to § 314 (3) of the Civil Code, be given within a reasonable period after knowledge of the reason for termination has been obtained. The terminating party is supposed to have time for consideration in order to give thought to its options and to be able to assess the previous occurrences. If notification of termination is not given within a reasonable period, it is invalid. The terminating party thus indicates that it did not consider the event objected to so serious that it would not be reasonable to continue the cooperation with the other contracting party until the end of the stipulated contract term or until the end of the

notice period for a termination for convenience (Federal Court of Justice, judgment of 29 June 2011 - VIII ZR 212/08).

The period of two weeks prescribed under labour law does not apply here, however. When a period is "reasonable" has to be determined on the basis of the circumstances of the individual case. The interest of the terminating party in terminating the agreement must be weighed against the interest of the other party in the continuation of the contractual relationship.

A period of up to one month is generally considered reasonable. A waiting period of two months can usually no longer be considered a reasonable period for considering the consequences.

In practice, it can sometimes be difficult to determine at what time the period for consideration begins. The supplier is not obligated to terminate the agreement at the occurrence of the first suspicions that there might be a compelling or important reason for termination. Instead, the period begins when the facts have been sufficiently ascertained.

Here, too, it must be pointed out again that the reasonableness of the period depends on the specific circumstances of the individual case, so the reasonable period might also be longer than two months in some cases.

2.1.4. Consequences of an unjustified termination without notice.

If a party declares the termination of the agreement without notice without being justified in doing so, for example, because there is no compelling or important reason (even if the party had perhaps erroneously assumed that such a reason existed) or because a warning ought to have been given beforehand, the legal consequence is that the termination is invalid. For this reason, it is advisable to give notice of termination for convenience (with notice), as a precaution, simultaneously with the notification of termination with immediate effect, because one cannot always interpret a notification of termination with immediate effect to mean that at the same time a notice of termination for convenience (with notice) was supposed to be given as a precaution.

An unjustified and thus invalid termination thus initially has no impact on the contractual relationship. The agreement continues to apply until the end of the normal notice period.

A recipient of an invalid — in its opinion — termination without notice should thus first offer explicitly to continue to perform the agreement. If the terminating party refuses the continuation of the contractual relationship — as is usually the case — the recipient of the termination may choose: it can do nothing and demand compensation for the loss it incurs because the other party does not perform the agreement (for example, a dealer whose contract is terminated without notice by the supplier without justification can demand compensation for the lost profits from the transactions to be expected up to the end of the normal notice period). Or it can terminate the agreement itself without notice, because an unjustified termination without notice constitutes a severe breach of contract that entitles the recipient of the termination to terminate the contract without notice itself. In addition, that party can demand compensation for the losses resulting from the early termination of the agreement.

3. Protection of investments.

For both types of agreements, the problem can arise that the dealers make large investments to build up their business at the beginning of the agreement. If suppliers withdraw from the agreement during this initial period, the dealers may have incurred great costs that are then lost. The concept of the so-called protection of investments was developed for this reason. At the beginning of the contractual relationships with suppliers, franchisees and distributors must gear their business to the new distribution systems. They must, for example, redesign their retail space, adjust the appearance of their operations and train their staff for the new type of distribution. Distributors often also set up workshops, procure work material for assembly and maintain a special spare parts warehouse for relevant products. Franchisees are usually very closely involved in the franchisors' distribution systems; their sales points must fit into the overall image of the franchise concepts. Their sales points must usually be rearranged extensively for this, which entails great expenditures. It also happens within the framework of franchise agreements that a franchisor obligates a franchisee to make investments based on the franchisor's authority to issue instructions.

The dealer thus makes great investments and relies on the expectation that the investment costs will pay off at a certain point during the

term of the agreement. If the supplier then terminates the agreement early, the dealer is left with the investment costs. The concept of protection of investments was developed in order to protect dealers from too great expenditures.

The legal concept of protection of investments is controversial. Most legal scholars agree, however, that such protection must exist. There is no legal foundation for protection of investments, just as there are usually no contractual provisions that protect dealers. For this reason, the basis is meanwhile usually the close contractual relationship between the two contracting parties. Between the parties to a distributorship or franchise agreement, there is a special permanent contractual arrangement from which increased duties to act in good faith arise. The parties must respect the interests of the respective other parties, and there is an especially strong duty of mutual consideration.

If dealers make investments at the instigation of suppliers, they usually rely on the expectation that their contractual relationships will last for a longer period of time and that the investments will pay off. If suppliers then terminate the agreement before the investments have paid off, they are acting inconsistently. This inconsistency becomes particularly clear where, for example, a franchisor places the burden of an investment on a franchisee on the basis of its authority to issue instructions and then terminates the franchise agreement soon afterwards. This is considered a violation of the principle of good faith (§ 242 of the Civil Code). According to § 242 of the Civil Code, an obligor has a duty to perform according to the requirements of good faith, taking customary practice into consideration. Section 242 of the Civil Code is a general statutory provision from which the idea of the prohibition of inconsistent conduct (*venire contra factum proprium*) was developed. A supplier's conduct is inconsistent if it causes a dealer to make investments in reliance on the continuing existence of the contractual relationship, but then terminates the agreement after a short time. It must be heeded that a supplier is not acting inconsistently if the dealer gave the supplier a specific reason for termination.

As a consequence of the prohibition of inconsistent conduct, two scenarios, mainly, are conceivable. First, one can consider the notification of termination invalid or have the termination come into force only later. Second, one can consider the notification of termination valid, but award the dealer a compensation claim to reconcile its interests. The fact that a supplier can have legitimate economic reasons that force it to terminate the agreement with the dealer is an argument

against the first scenario. If the suppler were not able to do this, its sales system might be blocked. In the second scenario, the interests of both contracting parties can usually be realised appropriately: the supplier can part from the dealer, but the dealer receives compensation for the investments made. The second option is thus usually preferable in the interests of both parties.

This also leads to a determination of the amount of the compensation claim. Compensation claims are supposed to provide compensation only for the investments that dealers made in the interests or even at the instruction of suppliers. Where dealers made investments in their own interests, they cannot demand the reimbursement of these costs; they come under the heading of the dealers' own entrepreneurial risk. The specific amount of the compensation claim depends on the circumstances of the individual case. The original contractual term is relevant, but primarily the time period required for the investment to pay off.

4. Post-contractual wind-up — compensation claims in particular.

a) Compensation claims

Since distributorship agreements and franchise agreements are not regulated by statutory law, there is no statutory provision concerning compensation claims of distributors or franchisees either. For commercial agency agreements, compensation claims are regulated by statute in § 89b of the Commercial Code. This regulation is based on Council Directive 86/653/EEC of 18 December 1986 on the coordination of the laws relating to commercial agents and provides for compensation claims only for commercial agents. It is thus not directly applicable to distributors and franchisees. They may have compensation claims under certain circumstances, however, if § 89b is applicable by analogy.

aa) Applicability of § 89b of the Commercial Code to distributorship and franchise agreements

The option of applying § 89b of the Commercial Code *mutatis mutandis* to persons active in distribution other than commercial agents is meanwhile generally acknowledged. The Federal Court of Justice applied this provision to distributors *mutatis mutandis* already in the 1950s (see Federal Court of Justice, judgment of 11 December 1958 - II ZR 73/57) and has been easing the prerequisites for this since then. As far as franchise agreements are concerned, however, the Federal

Court of Justice has not yet rendered a decision concerning the general possibility of analogous application of § 89b of the Commercial Code.

(i) Distributorship agreements

Within the framework of distributorship agreements, the analogous application of § 89b of the Commercial Code is largely acknowledged because the Federal Court of Justice confirmed the possibility of analogous application already at a very early stage. The Federal Court of Justice details in this regard that there is no impediment to analogous application of the provision to distributors "if the legal relationship between it [the distributor] and the manufacturer or supplier is not limited to a mere buyer-seller relationship, but the distributor was involved in the sales organisation of the manufacturer or supplier in such a way that it had to perform commercial duties comparable to those of a commercial agent to a considerable extent, and the dealer is furthermore obligated to transfer its customer base to the manufacturer or supplier so that the latter can make use of the advantages of the customer base immediately when the agreement terminates" (Federal Court of Justice, judgment of 6 October 2010 - VIII ZR 209/07).

The two prerequisites for analogous application can be derived from this:

(1) The distributor must be closely involved in the supplier's sales organisation like a commercial agent.

(2) The distributor must be contractually obligated to transfer its customer base to the supplier after the termination of the agreement.

The first prerequisite serves to ensure the characteristic involvement of the commercial agent in the supplier's distribution system because, unlike a commercial agent, a distributor — being an independent contractor — is generally not required to follow instructions. Due to the structure of distributorship agreements, however, distributors are often obligated to gear their business operations with regard to a number of aspects to the needs and wishes of the suppliers and to adapt to them. As a consequence, the distributors are no longer able to act on a completely independent basis as they would be entitled to as independent contractors. Therefore, they are — depending on the form, more or less — closely involved in the sales organisation of the suppliers so that they resemble commercial agents that must follow the suppliers' instructions and whose degree of independence is thus smaller. A typical example of a distributor that meets these requirements is a car dealer.

The second prerequisite serves to reproduce another characteristic of commercial agency relationships: Commercial agents act for suppliers in the name of the suppliers, they broker or conclude contracts with customers on behalf of the suppliers. Consequently, the customers are known to the suppliers and can be attributed to them. This is not the case with distributors. Distributors conclude their own contracts with customers in their own name, the customers can initially be attributed to the distributors. For a distributor to be comparable to a commercial agent, case law requires that the distributor is contractually obligated to transfer the customer base to the supplier after the termination of the agreement. It is thus warranted that the customer base can be used by the supplier immediately after the termination of the distributorship agreement — as is the case for commercial agents.

For the first prerequisite to be fulfilled, the distributor must be integrated into the distribution structure of the supplier similarly to the commercial agent. What is relevant in this regard is an overall assessment that makes the distributor appear similar to a commercial agent. This overall assessment may include the following points that suggest close involvement in the supplier's sales organisation:

- Non-compete covenants for the distributor
- Exclusive right of the distributor in the contractual territory
- Increased duty of the distributor to promote sales (e.g., by way of minimum revenues)
- Obligation to perform actions that concern only the external presentation of the supplier, e.g. advertising
- Staff training
- Establishment of customer service
- Setting up a goods or spare parts warehouse
- Supplier's authority to issue instructions
- Supplier's authority to control and monitor
- Distributor's duties to notify and report

All these points deprive distributor of parts of their entrepreneurial independence and make them appear to be merely a part of the suppliers' sales system.

For this first prerequisite for analogous application to be met, it is not required for all of the circumstances listed above to apply. It suffices if only some of them apply. Ultimately, the assessment of the overall circumstances is decisive.

The second prerequisite sets out that the distributor must be obligated to provide the customer base to the supplier. The supplier

must be able to make use of the customer base immediately after the termination of the agreement. Providing the customer base means that the relevant customer details (names, addresses, contacts) are disclosed to the supplier to enable the supplier to contact those customers. This obligation need not be set out explicitly, but may indirectly result from other contractual agreements; for example, if the distributor and the supplier have agreed that the distributor's customers are supplied directly by the supplier, or if the distributor is obligated to allow the supplier to inspect its business records. It makes no difference whether the customer data must be transferred during the contractual term or only after the termination of the agreement.

(ii) Franchise agreements

Unlike in the case of distributorship agreements, the analogous application of § 89b of the Commercial Code to franchise agreements is still debated. The Federal Court of Justice has not yet explicitly stated whether § 89b of the Commercial Code is applicable to franchisees. Franchise agreements are, however, closely related to distributorship agreements in terms of content. For this reason, a transfer of the prerequisites for analogous application of commercial agency regulations to franchise agreements is usually affirmed, in principle, by legal scholars. Especially for car dealers, with regard to which case law usually affirms the analogous application of § 89b of the Commercial Code, the agreements usually have all the typical characteristics of subordination franchising, even if they are not designated as franchise agreements.

The first prerequisite, the close involvement of the franchisee in the franchisor's system, usually causes few difficulties. As a rule, franchisees are so involved in the franchisors' franchise system, through many duties, that one speaks of a "quasi-outlet". The involvement of franchisees is often stronger than the involvement of distributors. As a rule, therefore, this prerequisite will be met.

The second prerequisite for analogous application, the obligation of a franchisee to transfer the customer data to the franchisor, on the other hand, is particularly difficult. In franchising systems in which franchisees operate a physical retail shop and the customers are largely anonymous, franchisees often also have no knowledge of the customer data. If the premises of the franchisees are linked to the franchisors, for instance, because the franchisors are the proprietors or the tenants of the shop, the premises are usually let to new franchisees by the franchisors after the termination of the franchise agreements. Very little

changes for the customers, so they will continue to buy at the same shop.

Even if there is no contractual obligation in such cases for the franchisees to provide the customer base, some legal scholars hold the view that the prerequisites for an analogous application of § 89b of the Commercial Code are met because the franchisors would ultimately benefit *de facto* from the customers in anonymous bulk business. The factual continuity of the customer base would lead in such cases to a situation in which the franchisor could immediately take advantage of the customer base. For this reason, it would be useless to require an obligation to transfer the customer base for the analogous application of § 89b of the Commercial Code.

In the ruling rendered by the Federal Court of Justice on 5 February 2015 - VII ZR 109/13 ("Kamps"), the court had to rule on the compensation claim of a franchisee that operated two in-store bakeries. Although the Federal Court of Justice again did not express its opinion in principle on the issue of whether a franchisee can have a compensation claim, it did deny a claim in this specific case and justified this by stating that there had been no transfer of the customer base by the franchisee to the franchisor. This requirement would have to be upheld, because a franchisee, unlike a commercial agent, would manage its own business and the customers were thus initially customers of the franchisee's. It would be irrelevant that the franchisee usually acted under the brand of the franchisor in its relationship with the customers, and not under its own brand. An anonymous customer base would not be immediately usable for the franchisor. A mere possible (actual) continuity of the customer base is not sufficient, in the opinion of the Federal Court of Justice.

It can be concluded from this that the Federal Court of Justice allows the franchisor's advantage that it takes over the customer base to be sufficient only if the franchisee is obligated to disclose the customer data to the franchisor. In franchising systems in which anonymous bulk business is conducted, it is not apparent how franchisees could be assumed to obtain the customer's data. Even if the Federal Court of Justice did not explicitly rule out the analogous applicability of § 89b of the Commercial Code to franchise agreements, this ruling *de facto* leads to the conclusion that franchisees will usually not have compensation claims in franchising systems with the purpose of distributing consumer goods of little value. In franchise systems for the purpose of distributing higher-value goods or services, on the other hand, com-

pensation claims are conceivable if the franchisees are obligated to transfer the customer base.

bb) Calculation of the amount of compensation claims

According to § 89b (1) of the Commercial Code, the purpose of compensation claims is to provide compensation for the advantages that a principal obtains because a commercial agent solicited new customers or because the business relationships with existing customers are significantly expanded (so-called "intensified" customers). Such advantages are to be expected only when the business relationships with such customers have a certain degree of stability. They must thus be regular customers. This compensation must be reasonable; above all, the commissions relating to those customers that the commercial agent would have earned and that it now loses in consequence of the termination of the agreement must be taken into account.

Therefore, although the advantages gained by the principal play a leading role in the calculation of the amount of the compensation claim, in court practice the compensation claim is usually quantified by the commercial agent calculating the lost commissions from business with the customers it solicited or intensified, because a presumption suggests that the advantages gained by the principal from a business relationship with a customer are at least as valuable as the commissions earned by a commercial agent.

If one applies these calculation principles to distributors and franchisees, a different factor for calculation from a commission must be found in order to apply § 89b of the Commercial Code analogously, because distributors and franchisees do not work on the basis of commissions but earn a profit by selling the products. The calculation of a dealer's compensation claim is usually complicated. An attempt is made in the following to provide an outline of the basic steps for the calculation of compensation claims under distributorship and franchise agreements, leaving out some calculations for the sake of simplicity. I assume that the calculation for a distributor and a franchisee (hereinafter: "dealer") would be identical if in both cases the prerequisites for an analogous application of § 89b of the Commercial Code are met.

The calculation of the compensation claim is made in several steps:

In a first step, the revenue relating to business with the regular customers solicited or intensified by the dealer that the dealer achieved in the last 12 months of the agreements is determined. Customers are considered regular customers if they bought a contract product from

the dealer at least twice during a period in which a customer usually makes one repeated purchase. A greater number of purchases can be necessary for consumer goods with shorter subsequent purchase intervals. From this, what the dealer paid to acquire these products from the supplier is subtracted. For the calculation, therefore, first the difference between the distributor's sales price and purchase price (the so-called gross profit) is decisive.

This gross profit is not the same, however, as the commission received by a commercial agent, because the dealer has to finance costs and risks from it that a commercial agent does not have, for example, storage and transport costs, the risk that a customer might become insolvent, the risk of not finding buyers for acquired products, etc.

In a second step, therefore, the business factors that are not typical for a commercial agent but that a dealer must finance must be deducted from the gross profit. The previously calculated gross profit from the sale of the products in the last 12 months to newly acquired or intensified regular customers is thus reduced to the extent that it is approximately comparable to the commission of a commercial agent.

In the next step, the so-called forecast period must then be specified. One must thus estimate for what period the dealer would have achieved this (reduced) gross profit if the agreement had not been terminated. This depends on how long a business relationship with a new customer of the dealer lasts on average. If there are sufficient statistical data concerning customer fluctuation, one can calculate this. If this is not the case, one can fall back on experience. The courts usually assume a forecast period of three to five years — depending on the sector and the market situation.

In the next step, the previously calculated (reduced) gross profit is extrapolated for the duration of the forecast period (thus, for example, for three years). Therefore, what (reduced) gross profit the dealer would have earned in the three years after the termination of the agreement is calculated. In doing so, however, steady profits are not assumed, but it is assumed that customers will also switch to the competition, discontinue their operations or be lost for other reasons during the forecast period (so-called churn rate). This can also be calculated on the basis of the average customer behaviour in the past if sufficient data are available. If such data are not available, an estimate can be made. As a rule, it is assumed that 20 to 30 per cent of the previous year's customers are lost each year.

In the above example of a three-year forecast period, assuming a churn rate of 20 per cent, the calculation would thus be based on the (reduced) gross profit from the last year of the agreement and reduce this amount by 20 per cent for the first forecast year. The result would then be reduced by 20 per cent for the second forecast year and again for the third forecast year. The sum of these three amounts must then be reduced by the interest advantage, because a dealer does not receive these amounts over a period of three years, but immediately in one lump sum.

In a last step, it must then be examined whether the calculated amount exceeds the statutory maximum for compensation claims. For a commercial agent, the compensation may not be higher than the annual average of the commissions or other remuneration received over the last five years, based not only on newly acquired or intensified customers, but on all customers. An analogous calculation can be made also for dealers, if the gross profit from business with all customers is reduced as described above. This calculation is in fact, however, somewhat more complicated, but explaining it would go beyond the scope of this article.

b) Other post-contractual duties

With regard to the early termination of the agreement, the question is how already exchanged services or objects should be dealt with. These are usually goods, replacement parts and documents that were provided by suppliers, but are in the dealers' possession. Dealers are often no longer interested in these goods when they may no longer advertise the fact that they are distributors, and their sales potential is thus lower. Suppliers, on the other hand, are often interested in having these objects returned.

aa) Distributorship agreements — obligations to return and obligations to accept return

After the termination of distributorship agreements, the contract goods initially remain in the possession of the distributors. If the distributors' chances of selling the goods are lower, for example, because they can no longer advertise the fact that they are the suppliers' exclusive distributors or because they have to compete with their successors, they have an interest in selling the contract products back to the suppliers. If, on the other hand, the products are easy to sell, distributors may have an interest in selling the contract products to their customers. Suppliers may also have an interest in buying back the

contract products in order to provide the distributors' successors with a "clean" territory in which no other dealer is distributing the contract products. Conversely, suppliers might be interested in avoiding the costs for repurchasing the products.

The parties to distributorship agreements should thus regulate in the distributorship agreements what is supposed to be done with the contract products stored on the distributors' premises. A dispute can arise if no such arrangement is made. Principles regarding such situations have been developed by the German courts; these are briefly described as follows:

Where distributors have purchased contract products from suppliers, they have acquired the ownership of the products and cannot, in the absence of contractual arrangements to the contrary, be prevented from using the suppliers' trade marks in the former contractual territories to the extent necessary to sell the contract products, in particular, in order to indicate in advertising what products are being advertised.

Distributors can have interests in selling the contract products back to the suppliers. When distributors purchase goods, however, they generally bear the entrepreneurial risk regarding the resale of the goods. If the parties have not agreed that the supplier will be obligated to repurchase the goods, distributors are generally not entitled to sell the contract products back to the supplier. The situation is different, however, where distributors have been obligated to keep a stock of merchandise. If this is the case, the entrepreneurial risk is shifted from the distributor to the supplier. It would violate the principle of good faith if a supplier were to obligate a distributor to keep a stock of the contract products, but the distributor could no longer successfully sell the stocked goods after the termination of the agreement.

The supplier's obligation to buy back the stock of merchandise applies only, however, to the extent the stock was not kept because of the distributor's own arrangements. Where distributors purchase goods in excess of their obligation to keep a certain amount of merchandise in stock, they must bear the entrepreneurial risk involved and may not return the goods.

Moreover, distributors may return only those goods that they purchased from the suppliers. This does not apply only in a selective distribution system. In this regard, the Federal Court of Justice also affirmed, in its judgment rendered on 20 July 2005 - VIII ZR 121/04 ("Honda"), an obligation of suppliers to accept the return of the products that distributors had purchased from third parties.

The obligation to accept the return of goods does not apply if the termination of the agreement was the fault of the distributor: it would be in bad faith towards the suppliers if distributors were to make a profit from something that was their own fault.

bb) Franchise agreement — repayment of entry fees and right to return the contract goods

The question arises with respect to franchise agreements, like with respect to distributorship agreements, whether franchisees have a right to resell the contract goods. Claims to the reimbursement of entry fees might also come into consideration.

Franchisees' rights to return contract goods are based on the post-contractual duties to act in good faith. There are often no contractual agreements on this.

The situation is usually as follows: a franchisee is closely involved in the franchisor's distribution system, which brings about a certain dependency of the franchisee. Owing to the increased duty to act in good faith, the stronger contracting party, the franchisor, must now cooperate in the return to status quo ante; it must respect the franchisee's interests. Franchisees, namely, have no realistic chances of selling the goods that they acquired within the framework of the franchise agreement when they are no longer part of the franchise system. Franchisees thus generally have a right to return the merchandise to franchisors. This right is limited or excluded where franchisees provide the reason for the early termination of the agreement. This is the manifestation of the prohibition of inconsistent conduct pursuant to § 242 of the Civil Code.

The answer to the question as to whether franchisees are entitled to reimbursement of the fees paid to enter franchise systems depend particularly on the purpose of the entry fees. There are usually no contractual provisions concerning reimbursements, so the purpose of the entry fees is decisive. Depending on what purpose they are supposed to fulfil, at least a *pro rata* reimbursement — depending on the duration of the contractual relationships — can be made. Where an entry fee is merely a fee for the provision of know-how by the franchisor, such a reimbursement claim will not apply, because — as a rule — the franchisee made use of the know-how immediately and in full upon commencement of the agreement.

Where there are no contractual provisions regarding the purpose of the entry fee, how the franchise agreement was terminated will be

relevant. Where franchise agreements are rescinded by franchisees due to deception or non-disclosure of salient circumstances, the franchise agreements will be terminated with retroactive effect (*ex tunc*). In such cases, the entry fees must be reimbursed in full. All of the franchisor's expenditures from which the franchisee benefited must be deducted, however (Federal Court of Justice, *NJW* 1995, 722). Where, on the other hand, franchise agreements come to an end by way of termination without notice (with effect *ex nunc*), it is assumed by the courts that the franchisees are entitled only to claims for a reimbursement *pro rata temporis* of the entry fees paid at the beginning of the franchise relationships and not yet completely used up because of the brief period of time.

Chapter V

TERMINATION OF FRANCHISING AND DISTRIBUTION AGREEMENTS IN NETHERLANDS

by *Hans Urlus* (*)

1. Introduction.

Although a franchise very often focuses on the distribution of services or goods, franchise is a cooperation that embodies more than distribution alone, but still is based on the defining elements of distribution. Dutch law does not provide a definition of franchise. The Netherlands Franchise Association's guidelines define franchising as "*a system for distributing products and services or exploitation of technology, based on close and lasting cooperation between legally and economically independent businesses*" (1). Licensing of various intellectual property rights (such as trademarks or signs) and providing know-how relating to the business formula comprise the core of this legal commercial concept. During the franchise the franchisor provides technical and commercial assistance to the franchisee. In return the franchisee pays a franchise fee to the franchisor for the usage of that type of business method. Generally the franchisee is considered to be interdependent from the franchisor.

In an ordinary distribution relationship a supplier enters into a distribution agreement with a distributor for the resale of the supplier's products. The distributor operates independently from the supplier, under its own name and within its own business model. In this commercial model it is up to the distributor to determine the manner

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(*) *Lawyer in Netherlands, Amsterdam-UrlusH@gtlaw.com*

(1) *www.nfv.nl/juridisch-over-franchising/.*

in which the contracted products are sold within the market. The supplier can merely influence this on the basis of the type of distribution model, which it agreed upon with the distributor, *i.e.* either an exclusive or a selective distribution model.

In the Netherlands mandatory laws do not regulate either of these legal commercial concepts. The legal concepts of franchise and distribution are governed by Dutch contract law and the general rules on competition law. Furthermore, these arrangements are also subject to the principle of contractual freedom. The specific elements, connected with defining the character of the above-defined legal commercial concepts, are determined in case law. This contribution provides a brief overview of Dutch case law and developments on the issues relating to termination of franchise and distribution agreements.

2. Duration of the Agreement.

Dutch law is based on the principle of contractual freedom. The contractual parties themselves determine the (commercial) terms and conditions of their own contractual relationship. The agreement is usually entered into for a fixed term. This term is typically up to a maximum of five years, either pursuant to Article 5(a) of the Block Exemption on Vertical Agreements if exclusive purchasing is required, or to align the term with the customary lease term for commercial real estate in the Netherlands.

For competition law reasons such commercial agreements tend to exclude (i) the possibility of tacit renewal for an equal term of the initial term or (ii) an indefinite extension. Therefore, the parties must negotiate their relationship's potential continuation at the end of each term. If the parties have not made any agreements or if they are unable to reach agreement on continuing the relationship, the agreement ends *ipso jure* after the agreed contract term.

It is however up to the parties to decide on the duration of their agreement, which can be either an open-ended or a fixed term. An open-ended agreement is established for an indefinite period whilst a fixed term agreement is entered into for a specific definite period. The duration of an agreement influences the ease and manner in which either one of the contractual parties can terminate the agreement. A fixed term agreement in general entails objective criteria, which govern its termination. The termination is triggered by those objective criteria

rather than the will of the respective contractual parties. This is different when the agreement concerns an indefinite period. Such an agreement is in principle entered into for a specific project or stock delivery. In the event that an agreement does not entail a specific clause for its duration, then the duration can be deducted by objective criteria. Key element in this assessment is that Dutch law allows for the courts to investigate what the intention of the parties was, and use the joint interest of the parties and what either party could reasonably have expected the agreement to imply.

3. Terms and Conditions of an Agreement.

Franchise

There are no mandatory clauses that must be included in franchise agreements. In order to accommodate the increasing franchise market in the Netherlands a Dutch Franchise Code was introduced on 17 February 2017. The Dutch Franchise Code contains best practices on the conduct of the franchisor and the franchisee and does not entail any best practice in relation with the termination of the franchise agreement. On 12 April 2017 the Dutch Minister of Economic Affairs published a draft bill, which envisages a statutory basis for the application of the Dutch Franchise Code. The reason for this contemplated enactment is the enforcement of the Dutch Franchise Code, as that code itself is based on the comply or explain principle.

Franchise agreements are focussed on a uniform business model, and often include clauses on exclusivity, protection of IP rights, protection of know-how and the reputation of the brand, as well as training obligations, coupled with on-going operational support by the franchisor.

EU Regulation 330/2010 permits, in addition to the regular non-competes for the duration of the agreement, the franchisor to contractually prohibit the franchisee from performing competing activities from the relevant franchise locations for (maximum) one year after the franchise agreement has ended, if such clause is necessary and proportionate to protect the interests of the franchisor (i.e. protection of indispensable know-how) after the duration of the franchise agreement.

Distribution

In general distribution agreements may entail clauses governing similar aspects as may be covered in franchise agreements. Clauses on exclusivity, protection of IP rights, training obligations, non-compete and confidentiality clauses can also be found in a distribution agreement. There are no mandatory rules defining specific terms and conditions of a contemplated distribution agreement. One could regard the absence of clauses in relation with the licensing of a specific business model to be the difference between a distribution agreement and a franchise agreement.

4. Legislation on Termination.

Franchise

There are no mandatory laws governing legal commercial concept of franchise in the Netherlands (2). Although there is no regulatory framework specifically applicable to franchises, franchises are subject to a number of laws and guidelines. These include: (1) the provisions of the Dutch general contract law; (2) the regulations of the Dutch competition authority, which ensures national compliance with European competition law; and (3) for franchisors that are members of the Netherlands Franchise Association, the European Franchise Federation's European Code of Ethics for Franchising (3), which, in addition to being a codified best practice, constitutes a guideline on the assessment of disputes between franchisors and franchisees.

Franchising generally is not covered by specific legislation outside the EU (4). Although until 2000 franchise was recognised in EU competition law as a discrete legal entity (Block Exemption on Fran-

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(2) Countries within the EU/EEA with specific franchise legislation are Lithuania and Italy. In Spain and France there are regulations on pre-contractual disclosure obligations. See, for example, Odavia BuenoDiaz, Franchising in European contract Law, Munich: Sellier 2008; Philip F Zeidman, Getting the Deal Through: Franchise 2008, London: Law Business Research 2007. Countries within the EU/EEA without specific franchise legislation include Austria, Finland, Germany, Greece, Poland, Portugal, Netherlands, Switzerland and the UK.

(3) *www.nfv.nl/juridisch-over-franchising/.*

(4) Countries outside the EU with franchise legislation include Australia, Canada, China, Korea, Malaysia, Mexico and Russia. Countries outside the EU without specific franchise legislation include India, Japan, Kuwait, New Zealand, Philippines, Puerto Rico, Singapore, South Africa and Ukraine.

chise Agreements) (5), this (specific) block exemption expired on 1 January 2000 and was incorporated into the, more general, Block Exemption on Vertical Agreements (No. 330/2010) (6).

Distribution

Absence any mandatory laws that regulate the legal concept of distribution it is still required that a distribution relationship meets the requirements stemming from the Dutch principles of reasonableness and fairness and good faith. The parties are required to deal with each other in good faith.

Dutch courts may set aside contractual provisions that are extremely one-sided in favour of a stronger party and at the expense of a weaker party. In doing so the Dutch courts may use the reasonableness gloss to protect weaker parties from inequitable contractual terms. In so doing, courts will consider parties' relative economic power, the contract's duration, parties' investments in the contract and parties' reasonable expectations.

5. Termination of the Agreement.

The termination of a commercial agreement is a frequently contested aspect of a commercial relationship in the Netherlands. There is no general legislation addressing the termination of a franchise or distribution agreement and the required notice period. In principle, continuing performance agreements may be terminated at will, but that right is not without restrictions. The agreement, the law, the standards of reasonableness and fairness or customary practice may impose

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(5) Regulation No. 4078/88 on the application of Article 85(1) to franchise agreements, OJ 1988. L 359/46.

(6) Commission Regulation (EC) No. 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices (Block Exemption Regulation on Vertical Agreements). However, the validity of the Block Exemption Regulation on Vertical Agreements expired on 31 May 2010 and it was replaced by Commission Regulation (EU) No. 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices (OJ L 142 of 23 April 2010) and its Guidelines on Vertical Restraints, which entered into force on 1 June 2010. As this chapter will appear after that date, the references below will relate solely to Regulation No. 330/2010 (Block Exemption on Vertical Agreements); see *http://ec.europa.eu/competition/antitrust/legislation/vertical.html*.

constraints on termination. Assessing whether or not termination of the continuing performance agreements is legally valid will depend on the relevant circumstances (7).

Termination of a franchise or distribution agreement before the end of the term is permissible if the parties agreed on the circumstances justifying an early termination. Examples of circumstances, which may trigger such early termination, are unforeseen circumstances, bankruptcy and loss of control in the undertaking. Dutch case law determines the general rule that a distribution agreement entered into for a fixed period, or for the attainment of a certain goal, cannot be early terminated (8) (unless parties agreed otherwise) whilst a distribution agreement entered into for an indefinite period can be terminated early with the prerequisite that the termination ground is reasonable and fair (9).

Any early termination of a fixed term agreement, especially when the agreement lacks a clause governing such early termination is subject to the principle of reasonableness and fairness. When the agreement requires a negotiated extension, premature termination is permissible in the event of failure, in spite of numerous attempts by the franchisee, to negotiate the agreement's possible extension (10).

Fixed term agreement

Generally, in the absence of special circumstances, a continuing performance agreement that has lasted for a reasonable number of years may usually be terminated, provided that:

1. there is cause to terminate (11);
2. sufficient notice is given; and

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(7) Supreme Court, 3 December 1999, NJ 2000, 120 (Latour v. De Bruijn).

(8) Supreme Court 21 October 1988, ECLI:NL:HR:1988:AD0483, NJ 1990/439 (Mondia/Calanda); Supreme Court 10 August 1994, ECLI:NL:HR:1994:ZC1428, NJ 1994/688 (Aerts/Kneepkens).

(9) Supreme Court 3 December 1999, ECLI:NL:HR:1999:AA3821, NJ 2000/120 (Latour/De Bruijn); Supreme Court 28 October 2011, ECLI:NL:HR:2011:BQ9854, NJ 2012/685 (Gemeente De Ronde Venen/Stedin); Supreme Court 14 June 2013, ECLI:NL:HR:2013:BZ4163, (Auping/Beverslaap).

(10) District Court of Utrecht, 15 April 2009, LJN: BI1190 (Run2Day Franchise BV v. defendant).

(11) Supreme Court 28 October 2011, ECLI:NL:HR:2011:BQ9854, (De Ronde Venen/Stedin); Supreme Court 14 June 2013, ECLI:NL:HR:2013:BZ4163, (Auping/Beverslaap); District Court of Zwolle-Lelystad, 1 February 2012, ECLI:NL:RBZLY:2012:BV6131; District Court of Zwolle-Lelystad, 23 March 2012,

3. a reasonable notice period is observed (12).

Compelling reasons (cause) for termination would include, for example, a situation in which continuing the relationship would jeopardise the existence of the terminating party, or where there was a risk to its reputation.

All circumstances of the case must be taken into account when determining the existence of a substantial cause for termination and whether the notice period was sufficient.

Examples of relevant circumstances are:

— the duration of the agreement,

— the legitimate expectations of the terminated party in the continuation of the agreement,

— the amount of the investments made by the terminated party in the commercial relationship,

— the time required for the terminated party to earn its investments back,

— the extent of dependency of the terminated party to the commercial relationship;

— the terminated party's possibility to find an alternative business model,

— whether the terminated party can make alternative arrangements to compensate the decrease of its revenues;

— the reason for the termination.

As regards the duration of the notice period it has been usual practice to connect that notice period with the total term of the commercial relationship when determining the reasonableness of notice period given to the terminated party.

If the agreement is terminated contrary to the principles of reasonableness and fairness, for example without the application of a notice period, the termination is considered to be null and void and is generally subject to payment of compensation for damages (13). The principal could also be obliged to compensate any damages suffered by

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ECLI:NL:RBZLY:2012:BW1035; District Court of Zwolle-Lelystad, 1 February 2012, ECLI:NL:RBZLY:2012:BV6131.

(12) Court of Appeal, Arnhem, 10 February 1998, set out in Supreme Court, 3 December 1999, NJ 2000, 120 (Latour v. De Bruijn), District Court of Utrecht, 18 April 2007, LJN: BA3564 and Interlocutory Court of the District Court of Haarlem, 25 May 2004, LJN: AP0057.

(13) Supreme Court 6 February 2009, ECLI:NL:HR:2009:BG6231, LJN BG6231.

the distributor should the Dutch courts determine that the notice period of termination was too short (14).

Right on Compensation

Termination of a franchise agreement or a distribution agreement may have the consequence that the terminating party has to provide the terminated party (i) a compensation stemming from the agreement (if parties agreed upon such) and (ii) an additional compensation pursuant to the additional effect of the principle of reasonableness and fairness.

The compensation may take the form of:

(i) a period of notice;

(ii) compensation for investments;

(iii) payment for the client database built up by the terminated party (goodwill payments); or

(iv) a combination thereof (15).

However, if the terminated party does not suffer damages from the termination of the agreement then it can be regarded to be reasonable that the terminating party does not receive any compensation (16). The circumstance that the terminating party obtained a new agreement with another principal, after the termination by its old principal, is also taken into consideration when determining whether the terminated party should be compensated for the termination by its old principal (17). More specifically for the franchisee, on the basis of Dutch rent law, the franchisee who is the tenant of the franchisor, may claim a specific goodwill claim for e.g. retail operations conducted (18).

Terminating the agreement may be contrary to good faith if the terminated party has made considerable investments at the principal's request, and which it has yet to recoup (19). Generally, reasonable compensation of the terminated party for termination of the agreement is required. The following investments can be subject to indemnification. Investments:

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(14) Supreme Court 21 June 1991, ECLI:NL:HR:1991:ZC0291, NJ 1991/742 (Mattel/Borka).

(15) Barendrecht/Peursem, Distributieovereenkomsten [Distribution agreements], Recht en Praktijk (Serie), Deventer: Kluwer 1997, p. 152.

(16) Supreme Court 15 September 2017, ECLI:NL:HR:2017:2372.

(17) Court of Appeal 20 January 2015, ECLI:NL:GHAMS:2015:137.

(18) Court of Appeal 26 September 2017, ECLI:NL:GHAMS:2017:3900.

(19) Interlocutory Court of the District Court of Utrecht, 2 September 2004, LJN: AQ8799.

— in the advertisement of the products;
— in the business premises;
— in regard to the IT-system;
— for an appropriate redundancy scheme for its personnel;
— in reparation services; and
— in the education of the distributor's personnel.

The terminated party has to make apparent that it has made investments for the continuation of the commercial relationship and that the notice period given by the terminating party does not take into account its interests. In determining the extent of compensation it is an acceptable method to compensate the net turnover, which the terminating party most probably would have gained if a reasonable notice period would have been taken into account, after the deduction of costs and other operating expenses (20). Another way of calculating compensation, as advocated in legal literature, is to fix the amount of compensation on 10 per cent of the average annual turnover over the last 5 years.

(20) Supreme Court 21 June 1991, *LJN* AX2470.

Chapter VI

TERMINATION OF FRANCHISING AND DISTRIBUTION AGREEMENTS IN UK

by *Rocco Franco* (*)

1. Introduction. — 2. Franchising. — 3. Termination.

1. Introduction.

Distribution and franchising: key aspects and differences

Distribution and franchising are both forms of commercial agreements within a business context. They both include a high element of co-operation between the contracting parties and share a number of similarities, however they are not the same.

There are a number of differences between distribution agreements and franchise agreements. One of these differences is the core concern of the agreements: a franchisor for example will be more concerned that the franchisee follows specific quality control procedures and pays a contractual royalty to use the franchisor's brand name and know-how as opposed to forcing the franchisee to purchase its raw materials from the franchisor. As such, a franchising agreement, in theory, necessitates far more co-operation between the parties, thereby rendering a much more intimate commercial relationship in comparison with the relationship that exists between a producer and a distributor.

Another key difference is exclusivity. It is more common for producers within distribution agreements to concern themselves with competition from other producers and therefore require exclusivity with a distribution agreement. Exclusivity for franchise agreements

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(*) *Lawyer — Solicitor of the Senior Courts of England and Wales; www.pinifranco.com rfranco@pinifranco.com*

however as not always as salient so long as the brand which is being franchised is not confused with other brands.

Know-how is another key difference between distribution and franchise agreements. Know-how is imperative to franchise agreements in order for the franchisee to offer the same quality of product/service as other franchises, whereas for distribution agreements, a distributor may not require any access to know-how in order for the commercial purpose to be satisfied as part of the distribution relationship.

The most significant difference however, is royalties. Under a distribution agreement, royalties are not payable. A distributor merely makes its profit under its own resale margins. A franchisor will however charge royalties in consideration for granting the franchisee a right to use the franchisor's branding, business operation model and know-how.

Overall, despite sharing a certain degree of similarity, distribution and franchising remain principles that are independent of each other; nonetheless, there is room for them to overlap where circumstances permit. Such circumstances will most likely arise when a distribution arrangement that exists between a distributor and a producer is underpinned by a franchising agreement, whereby a producer/supplier is simultaneously a licensor to the distributor/licensee. As an illustration of this concept, consider the following facts: one business produces a commodity and sells it through its own commercial outlets; however, this producer also grants a licence for resale to the commercial outlet of another party, thereby permitting the other party to sell the commodity through its own stores. On these facts, the relationship between the two parties is simultaneously that of licensor/licensee and of producer/distributor.

Regulation: a typical contract and application by analogy of rules stated for other contracts

A distribution agreement usually entails one party, the distributor, buying commodities from another party, the supplier, then reselling the commodities on to a third party; the customer. They are generally cheaper alternative to franchising as a means of entering a new territory or market, due to the supplier playing a much smaller role in the future of its products once they have been sold on to the distributor.

2. Franchising.

Definition from: British Franchise Association, key franchising facts

The British Franchise Association (**BFA**) defines the procedure, in business, of 'franchising' as; '*the granting of a license by one person (the franchisor) to another (the franchisee), which entitles the franchisee to own and operate their own business under the brand, systems and proven business model of the franchisor*.' In other words, franchising involves outsourcing of stock, branding, and powers to sell, to another party. The effect of this is that decentralises the franchisor's business mode of operation to unrelated, in raw terms, commercial outposts.

Franchising is very common in the world of British and global business today; it is very likely that everyone uses the services of at least one franchised business either personally or professionally every day. This is naturally the case considering some nearly 1000 franchisors operate in the United Kingdom today. There is a clear dominating presence within the market with the likes of McDonald's, KFC, Subway and Burger King on the international market, and the rapid expansion of chains in the UK such as Tesco, Pret a Manger and Wetherspoons, speak volumes about the growing position of franchising in today's world.

To give an idea of the scale of franchising operations in the UK: the annual turnover of the franchising industry in 2015 alone, was somewhere in the region of £15.1bn. Meanwhile, circa 625,000 employees working for franchised businesses operate through some 44,200 outlets. In comparison, twenty years ago, the annual turnover of the franchising industry was £5 billion, and there were just 18,300 franchise outlets in the commercial districts of the UK (sources: *figures extracted from the NatWest Franchise Survey 2015, as displayed on the British Franchise Association's website. Consumer reasons for choosing franchises extracted from Startups.co.uk and Nation's Restaurant News*).

These figures illustrate the growth experienced by the franchising industry over the past twenty years, and the industry looks as though it will continue its upward trajectory as we head towards the mid-21st century, with consumers stating reliable service, higher standards and value for money as their primary incentives for buying from franchises.

'Business Format'

The BFA defines 'business format' franchising in the following way: '*the granting of a license by one person (the franchisor) to another (the franchisee), which entitles the franchisee to trade under the trade mark/trade name of the franchisor and to make use of an entire package, comprising all the elements necessary to establish a previously untrained*

person in the business and to run it with continual assistance on a predetermined basis'.

Essentially, 'business format' franchising summarises the concept of franchising in its quintessential form i.e. that one party transfers its expertise and method of trading to another party, which thereby permits the receiving party to present itself on the market as identical to the other company, with the effect of rending the two parties distinguishable from one another where the consumer is concerned. Where the commercial agreement between the parties does not meet the above description outlined by the BFA, the commercial agreement in question will not be in the form of a franchising agreement, even if it appears to be on the surface, and it is more likely to be a regarded as a licensing agreement or a partnership.

Some types of contracts in English law have terms implied into them by statute. This is common in agreements for lease or contracts for the supply of goods and services which require co-operation and good relations between the parties. Implied terms are not implied into franchising agreements. Thus, all the terms on which franchising agreements are based, are express terms. This means that they are explicitly referred to in the contract that underpins the arrangement and are explicitly agreed upon by both parties. Accordingly, it is not normally possible to breach an implied contract term in the context of a franchising arrangement.

Master Franchise Agreement

Managing a franchise stretched over a vast geographic space comes with its difficulties. One method that franchisors have deployed to counter issues caused by this is the 'master franchise agreement'. This concerns a master franchisor granting a master franchisee the ability to sub-franchise to a third party. The effect of a master franchise agreement is that power becomes decentralised away from the master franchisor, thereby rendering easier management of a geographically dispersed franchise through its master franchisee outposts. The 'master franchise agreement' is particularly prevalent in the services sector, however a notable number of restaurant businesses also use this form of franchising.

To summarise, master franchise agreements are created with the purpose of making the world a bit smaller for the master franchisor. That is to say, such agreements are created with the intention of making

businesses that have a presence over a vast geographic area easier to manage.

One significant possible effect of entering into a franchise is decentralisation of power away from the parent company. Master franchise agreements act as clear illustrations of the way in which franchising can have the effect of decentralising powers away from the parent company to the master franchisees. On top of containing the standard features of a franchising agreement, of transferring information, business tactics and so on, they also grant the smaller party to the agreement various administrative powers in relation to how the business will be operated through sub-franchises in a given geographic territory. This is significant in that it illustrates the way in which franchises provoke shifts in the balance of power within the world of business, away from large companies and towards smaller companies in the form of master franchisees.

Franchise Development Agreement.

Similar to a master franchise agreement is a 'franchise development agreement', also referred to as a 'master development agreement'. Thomson Reuters Practical Law defines this concept as '*an agreement entered into by a franchisor and an operator where the operator is obliged to operate franchise outlets itself within a specified area and cannot sub-franchise to third parties'*. On the surface, this appears to be identical to a master franchise agreement analysed above. However, franchise development agreements are different in that they involve 'developing' the business.

In this type of franchising arrangement, powers are further decentralised away from the master franchisor, and towards the master franchisee. Under such a franchising agreement, the master franchisor has the task of growing the franchise, hence 'development', in the geographic area over which it has been granted responsibility by the master franchisor.

The terms of the franchise development agreement will usually stipulate that a specific number of franchises must be developed and maintained within a specific period of time and may include a clause that allows the developer to sub-franchise in the territory. If the developer fails to meet the quota, it is likely that the master franchisor will seek to revoke certain powers, or terminate the development agreement altogether, for the simple fact that its business objectives were not achieved.

This particular form of franchising can be very useful to businesses that have ambitions to expand into other markets but do not have the means to do so. Moreover, it can be useful in situations in which the master franchisor does not have the requisite knowledge of the market that it wishes to break into. Creating agreements with master franchisees that have more experience of trading in the targeted territories, the master franchisor has the benefit of applying the master franchisee's knowledge of the local regulations and local practices of the area through franchisee's outlets. One set back of granting a master franchisee more powers is that a greater portion of the franchise's revenue will pass to the franchisee, but this can be viewed as a fair price to pay in return for the potential benefits, listed above, which are offered by the master franchisee.

Legal Relevance of the Operating Manual

The operating manual of a franchise is the most important component of any franchising agreement, as it acts as a comprehensive guide for the master franchisee to follow, containing information and directions in relation to how the franchise should be run. Some areas over which the operations manual may concern itself include; staff requirements, how equipment is to be operated and standard procedures. It plays a central role in the transfer of knowledge and expertise between the parties to a franchise agreement and ensures the smooth running of the franchise.

The master franchisor will also use the operating manual not just as an instrument through which to transfer raw practical knowledge, but also soft purpose of reflecting the company's culture and ethos. Overall, the operating manual acts as a comprehensive and regulative source for the master franchisee to follow which sets the standard of performance expected of the franchisee by the franchisor.

Furthermore, the operations manual is more than a mere guide. Although it is not a legally enforceable by default, it is nonetheless legally relevant in nature. The manual can be used as a yardstick against which performance can be measured and depending on the specific provisions of a franchising agreement and the implications of failing to meet the standard set by the manual can result in a breach of contract. Therefore, the extent to which an operations manual is legally enforceable varies from case to case and depends on the type of provisions included in a specific contract.

As the franchisor alone is responsible for drafting the operations

manual, the standards that the franchisee is expected to meet in its running of the franchise are completely determined by the franchisor. This aspect of a franchise agreement plays a part in explaining why; legally speaking, franchise agreements are generally viewed as being very one-sided in favour of the franchisor, as the franchise is operated on its terms without any input from the franchisee.

Overall, the operating manual is a powerful tool that the master franchisor can make use of in order to ensure that standards are met in all of its franchising outlets. Equally, the franchisor may use the operations manual as a means to bring legal action against a franchisee where such a provision is incorporated into the franchising agreement. Due to the level of legal importance of a franchising varying from case to case, it cannot be said to be a legal document in and of itself. However, due to the potential legal repercussions that the manual may have when a franchisee falls foul of its requirements, it is certainly a document of legal relevance.

International Franchise: Local Aspects

An international franchise is a franchise that stretches across borders, involving the franchisor entering into franchising agreements with third parties based outside the franchisor's home country. In order to decide how best to implement an international franchising ambition, the prospective international franchisor must consider whether to enter the targeted foreign market alone or to enter the market in question via liaison with a third party already established in that targeted market. The answer to this obstacle very much hinges on the extent of cultural and linguistic similarity that exists between the franchisor's host country, and the new country in which it wishes to begin trading.

Where cultural and linguistic circumstances permit, a franchisor may choose to trade in a new country under a 'direct franchise' arrangement. This type of arrangement may be suitable when a franchisor seeks to expand into a market situated in a territory that is linguistically and culturally similar to the franchisor's home territory; for instance, direct franchising would be a feasible option to a German company that seeks to expand its franchise into Austria, or vice versa.

What distinguishes direct franchises, from other forms of international franchises is the heavy involvement retained by the franchisor in relation to running the franchisee's affairs. Hence, direct franchising is far from being a master franchise agreement or a franchise develop-

ment agreement, where the franchisor has a limited role in running the franchisee's affairs. Instead, the franchisor retains a significant amount of responsibility, namely; recruiting, training and supporting its franchise network, through long-distance control from the headquarters, a subsidiary office in the target country or an appointed agent.

At a local level, a direct franchising arrangement may limit the extent of benefit endowed on the local economy. Specifically, the franchise may choose to use already existing employees from the franchisor's host country, rather than recruit from the local area. Meanwhile financial benefits will be limited because the franchisor is entitled to a greater share of revenue, due to its heavy involvement in the running of the franchisee's branch.

When the requisite linguistic and cultural conditions are not present, i.e. where a German company is seeking to expand into Brazil rather than into Austria, the franchisor will most likely operate via a third party, perhaps in the form of a master franchise agreement or a franchise development agreement (analysed above). In such an arrangement, there is a presumption that the third party will have superior knowledge and understanding of the local market in the targeted territory in question. As such, the franchisor will be significantly less involved that it would be under a direct franchise agreement, because the franchisee is granted far more autonomy in the running of its franchise branch.

Consequently, the effects, at a local level, of an international franchising agreement, in which the franchisee is granted more control, is greater. There is a stronger chance that the franchisee will employ people from the local area, meanwhile less of the revenue generated by the franchisee will be shared, thereby keeping more of the profit made within the boundaries of the local economy.

However, in any case, international franchising may influence a change in local cultural habits, however small. This is naturally the case considering that the outsourcing of a franchise abroad is a form of cultural exportation. The effect of such cultural exportation can be illustrated by the fact that much of the global diet, from Egypt to Japan, includes burgers; something that can be attributed to the successful franchising policies of the largest international franchise in the world: McDonald's. Thus, but for McDonald's vast network of franchises across the world, burgers would not be so prevalent in the global diet.

3. Termination.

Termination of Contract in English Law

Termination describes a contract coming to an end early or by expiring. A contract can be terminated under two ways: 1) by the triggering of a termination clause or 2) under common law (*Aktielselskabet Dampskibsselskabel Svenborg v Mobil North Sea Ltd [2001] EWHC 518, paragraph 17*).

Termination does have the effect of undoing the contract as if it had never existed. This is the case in Rescission only. Rescission is the concept in English law of a contract coming to an end, with the effect of returning both parties to the position they were in before the contract was made. In other words, rescission undoes the contract as though it never existed. Rescission can come about by agreement, or as a remedy for some wrong. Termination is very different to rescission. The effect of termination is that it removes both contracting parties from their duties to perform further contractual obligations they may have. However, it is possible that some duties can continue after a contract has been terminated, such as the duty to pay damages for a breach made before the contract was terminated.

When Might a Party Wish to Terminate a Contract?

There are numerous reasons why a party may wish to terminate a contract. The most common reasons are when a party is not properly performing its contractual duties, refusing to perform the contract for any reason, or breaching a condition or term of the contract.

Other external reasons may also exist where for example, a customer stops needing the goods or services, or where one of the parties goes into insolvency, where one party has been bought by the other's competitor, or where one party has serious concerns regarding its reputation being damaged as a result of the other party's conduct of affairs.

How to Terminate a Contract

Some positive action is generally required in order to terminate a contract. Equally, some positive action is also normally needed to terminate a contract at common law.

Before a party terminates a contract, that party should first establish whether it has the requisite grounds for termination. It is also advisable to consider both the practical implications of termination. Once they have determined to proceed with termination they will need

to ensure they comply with with any procedural requirements under a contractual right or at common law.

When considering the legal grounds for termination, both contractual and common law rights must be measured. This should always be the case even if common law rights are not explicitly written into the contract. Where there is an express termination clause, this does not override any common law rights to terminate on breach of contract.

Assess the Grounds for Termination

In some cases, legislation may influence the rights of a party to terminate a contract. Two examples of such legislation are the Sale of Goods Act 1979 (**SGA**), the Unfair Contract Terms Act 1977 (UCTA) and the Consumer Protection Act 2015 (**CPA**). The SGA allows for a party to terminate a contract where goods are faulty, and where the sole remedy provided for in the contract is damages. It is possible for a contract to exclude SGA if done so explicitly, however these contractual provisions apply where the contract is silent.

Meanwhile, UCTA restricts the extent to which the franchisor can exclude or limit its liability to the franchisee by the use of exclusion and limitation of liability clauses. Under UCTA it is also not possible to exclude or limit liability for death or personal injury arising from negligence, or for fraud. The CPA does the same but applies to contracts that where entered into on and after the 1st of October 2015. The main difference between these two acts is that UCTA applies solely to non-negotiable terms, whereas the CPA applies to both negotiable and non-negotiable terms.

Assess the Implications of Termination

Once the party wishing to terminate the contract has established that the requisite grounds exist, it should then consider the commercial implications of terminating that contract. For example, it should establish whether transitional arrangements are required (like selling of products or switching to an alternative provider). Likewise, the implications for employees should be assessed, as well as the implications for the party who wishes to terminate for getting it wrong. Further, duties may arise (possibly onerous) for the party who terminates. Thus, depending on the nature of the post-contractual duties imposed on the other party, it may be a better decision for the party not to terminate.

Establish Whether Affirmation Would Be More Profitable

A breach of contract by one party can result in making it impossible for the other party to perform its obligations under the contract. In such circumstances, it is best to terminate for breach, as the contract becomes useless. However, sometimes it can be financially pragmatic for the aggrieved party to accept continued payments rather than seek compensation by way of damages. Where this is the case, it makes more sense to affirm the contract rather than terminate it. If the aggrieved party wishes to terminate for breach, there may be issues of causation, remoteness, mitigation and proof.

Termination of Franchise

The general rule is that a franchise agreement cannot be terminated by a franchisee as they are always anchored by fixed term contracts (normally of five years). Nonetheless, in English law, there are no specific provisions relating to the termination of franchise agreements. Under common law principles, either party to a franchise agreement would be permitted to terminate by virtue of a fundamental breach of contract. That is to say, a breach so severe that it appears that the other party no longer has any interest in being bound by the contract. The franchise agreement will normally list the circumstances in which either party may terminate, i.e. by express terms, or by the other party's insolvency.

A franchise agreement will usually include more provisions on which a franchisor can terminate a franchise than a supplier can terminate on a distribution. The reason for this being that a franchisee is utilising the franchisors name, branding and company know how and so the compliance requirements will be much more stringent. As such, a franchise agreement will grant termination rights on breach of quality control compliance, upon receipt of complaints of the franchisee business and on breach or termination of a trade mark licence.

Express Terms

Contracts will normally include express clauses detailing the circumstances in which a party to a contract has the right to terminate. These clauses are included to provide a party with the chance to escape its contractual obligations where conditions are unfavourable, and where it either sees no point in continuing its legal relationship with the other party, or where it is making a loss because of the contract's failure to promote profitable business.

Although a franchise agreement will normally grant rights to terminate to a franchisor, it will not necessarily give these rights to the

franchisee. This is because franchise agreements are drawn up by the franchisor, so due to this one-sidedness they are likely to be tailored more favourably to the interests of the franchisor.

Because of the high financial and reputational risk to the franchisor involved in granting rights to another party to represent its company, the franchisor will often ensure that it has the ability to terminate the contract swiftly in the event that the franchisee does not meet the franchisor's requested standards of business operation and customer service. Therefore, a franchising agreement will normally provide express contractual terms permitting the franchisor to terminate where, for instance, the franchisee is failing to meet fee payments. Equally, franchisors normally have a contractual right to terminate if it receives a substantial number of client complaints, signalling a poor standard of service on the part of the franchisee.

The type of wording used in an express termination clause is very important. The franchisor must ensure that the wording covers all the possible situations that may arise that can trigger a desire to abandon the contract. Below is an example of how an express term relating to termination is worded in a franchise agreement:

(1) The Franchisor may terminate this Agreement forthwith by notice in writing to the Franchisee:

(a) If the Franchisee shall have committed any material breach of his obligations hereunder or shall have failed to remedy any remediable breach within a period of twenty-eight days of the receipt of a notice in writing of the Franchisor requiring him to do so;

(b) If the Franchisee shall commit an act of bankruptcy or have a receiving order made against him or make any arrangement or assignment with or for the benefit of his creditors or suffer distress or execution to be levied or threatened on any of its properties;

(c) If any sum or document required under the terms of this Agreement is not paid or submitted at the latest within twenty-one days following its due date;

(d) If the Franchisee ceases or takes any steps to cease his business;

(e) If the Franchisee challenges the Franchisor's intellectual property rights.

(2) The termination or expiry of this Agreement shall be without prejudice to any rights and obligations conferred or imposed by this Agreement in respect of any period after such termination and shall also be without prejudice to the rights of either party against the other in

respect of any antecedent breach of any of the terms and conditions hereof.

An express right to terminate on grounds of a breach may require the terminating party to provide a reasonable chance for the party in breach to remedy that breach within a specified period of time. Where this is provided for and a party who was in breach has adhered to the conditions and remedied their breach, and the terminating party still elects to terminate the contract, the termination would be deemed unjustified and could be a repudiatory breach. It is possible to draft 'remedial' provisions that limit the common law right to terminate on grounds of a repudiatory breach. Each contract will be a question of interpretation as to whether the remedial provisions apply to the termination rights under the contract, or also to the common law right (*Vinergy International (PVT) Ltd v Richmond Mercantile Ltd FZC [2016] EWHC 525*). The wording would usually need to be very clear to remove this common law remedy for breach. Certain breaches are not deemed to be 'remediable' such as breach of confidentiality. Once this has occurred, it cannot be taken back whereas a breach for failure to pay can usually be cured by late payment fees and interest payments. This was confirmed by Lord Justice Lewison and the Court of Appeal in *Kason Kek-Gardner Ltd v Process Components Ltd [2017] EWCA Civ 2132, paragraph 58*. In (Wickman Machine Tool Sales Ltd v L Schuler AG [1974] AC 235) Lord Reid went on to state that the meaning of 'remedy' should not be restricted to cases where all damage past and future can be put right. He went on to state that to allow this "would leave hardly any scope at all" for a remediable breach clause.

At Common Law

As established in the above section, franchise agreements rarely grant franchisees rights to terminate in the same way that they grant franchisors rights to terminate. This does not mean that franchisees cannot terminate a contract at all — they will simply have to do so by other, non-contractual, means. Franchisees will therefore often look to common law when they wish to terminate a franchising agreement. Unfortunately for franchisees, the rights granted to them at common law are rarely clear-cut, and they do not benefit from common law rights granted to parties in non-fixed term contracts, which are more favourable.

There is no common law right to end a contract for the following:

- Insolvency or threatened insolvency.

• Material breach (unless "material" is interpreted as repudiatory).

A party wishing to terminate a contract may rely on termination under termination clause or at common law where there is no difference between a terminating party's rights or consequences of termination. They do not necessarily have to choose between them. It may be possible to invoke both rights at a later stage, even if the terminating party did not rely on them both to begin with (*Stocznia Gdynia SA v Gearbulk Holdings Ltd [2009] EWCA Civ 75*).

However, if the two termination rights have inconsistent consequences, the terminating party must choose between the rights and cannot exercise both. Once a terminating party has committed itself to one course, it cannot then go back at a later stage and chose the other.

The terminating party therefore needs to make it very clear what choice it is making when terminating. Where it is unclear, it will be a question of fact and interpretation from its words and actions, to see which right(s) it exercised.

A contract may exclude any other termination rights other than under contracts termination provisions. Where this is utilised, clear and express words must be used otherwise where the contract is silent on this, it is generally presumed that neither party intends to abandon remedies for breach arising by law (*Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd [1974] AC 689*).

A right to terminate on reasonable notice is usually implied where it is necessary or obvious, to give the contract business efficacy. The usual rules apply on contract interpretation and implied terms (*Winter Garden Theatre (London) Ltd v Millennium Productions Ltd [1948] AC 173, pages 195, 198 and 203*). The best ground for an implied right to terminate on reasonable notice is that the contracting parties cannot have intended for the contract to last forever (*Staffordshire Area Health Authority v South Staffordshire Waterworks Co [1978] 1 WLR 1387*). The test of business efficacy is rarely met in fixed term contracts or in contracts which include express terms of termination and so is uncommon in franchise agreements where fixed term contracts are almost always used and which are certain to contain termination rights. Where this is the case, the courts are not usually minded to imply a term allowing a terminating party to terminate by reasonable notice without cause (*Jani-King (GB) Ltd v Pula Enterprises Ltd [2007] EWHC 2433).*

When considering what is 'reasonable' notice, relevant factors usually include; how long the terminated party would need to replace the contract which has been lost, how much the terminated party

depends financially on the contract, the commitments of the parties, notice periods and the relationship between the parties. It is often a question of fact, taking into account all the circumstances of the matter when notice is given (*Martin-Baker Aircraft Co v Canadian Flight Equipment [1955] 2 QB 556).*

Where franchisees supply to consumers, the Unfair Terms in Consumer Contract Regulations 1999 provides that unfair terms, which are contractual terms which have not been individually negotiated and which cause a significant imbalance in the parties' rights and obligations to the detriment of the consumer, will not be binding. The Consumer Protection from Unfair Trading Regulations 2008 (Regulations) will also apply. These contain a blacklist of commercial practices which are automatically deemed to be unfair while a number of other commercial practices are prohibited depending on the effect on the average consumer. The Regulations cover areas such as advertising and debt collection.

Furthermore, bringing a claim in misrepresentation can be an effective way for a franchisee to end a franchise agreement at common law, too. Particularly relevant is s.2 of the Misrepresentation Act 1967 entitled 'Damages for Misrepresentation', of which sub-section (2) states:

(2) Where a person has entered into a contract after a misrepresentation has been made to him otherwise than fraudulently, and he would be entitled, by reason of the misrepresentation, to rescind the contract, then, if it is claimed, in any proceedings arising out of the contract, that the contract ought to be or has been rescinded, the court or arbitrator may declare the contract subsisting and award damages in lieu of rescission, if of opinion that it would be equitable to do so, having regard to the nature of the misrepresentation and the loss that would be caused by it if the contract were upheld, as well as to the loss that rescission would cause to the other party.

s.2(2) of the Misrepresentation Act 1967 grants power to the court to either rescind or award damages in lieu of rescission where a person, or franchisee has entered into a contract on the back of a misrepresentation having been made. This is an option available to both parties involved in a franchise agreement but represents in particular one of the main ways in which a franchisee can bring a franchise agreement to a premature end, due to the limited availability to terminate through contractual means.

Under distribution agreements, the amount of notice which is generally regarded as 'reasonable' depends on the circumstances of the case. In (*Jackson Distribution Ltd v Tum Yeto Inc [2009] EWCA 982 (QB)*), nine months was held to be 'reasonable' and the factors which were taken into account were; degree of formality, whether there was a clause for selling competing products, the length of the relationship and the extent of the early investment by the distributor and the percentage of the distributors turnover made up by the supplier's products. These factors were also taken into account in *Alpha Lettings Limited v Neptune Research and Development Inc [2003] EWCA Civ 704.*

By Notice

The franchise or distribution agreement are both governed by contractual law and are not regulated by statutory law. Accordingly, there is no statutory provision for termination. The franchise or distribution contract will govern the validity of the notice and may require specific delivery i.e. in writing by recorded delivery to a party's registered office. *In Trafford Metropolitan Borough Council v Total Fitness UK Ltd [2002] EWCA Civ 1513* the court held that there are two steps to take when deciding whether a notice complies with the requirements of the provision pursuant to which it is given (whether that is statutory or contractual):

- Stage 1: a consideration of what the notice says on its true construction.
- Stage 2: a matching up of the notice against the relevant requirements for that notice, to determine whether the notice meets the requirements.

Minor defects may not always invalidate the notice, if they would not confuse a reasonable recipient who knew the background (*Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd [1999] AC 749 (HL)*).

Where a contract is silent on notice, English law does not imply any rules into a contract to determine what form of notice to give when terminating a contract, all that matters is that the party's intention to terminate is both clear and unequivocal.

"*The parties cannot have intended termination to be brought about without [the party receiving the notice] knowing or having reason to know the significance of the alleged notice*"

(Jet2.com Ltd v SC Compania Nationala De Transporturi Aeriene Romane Tarom AS [2012] EWHC 622, at paragraph 52)

"*You must either affirm the whole contract or rescind the whole contract: you cannot approbate or reprobate by affirming part of it and disaffirming the rest of it*" *(Suisse Atlantique Société d'Armement Maritime v NV Rotterdamschke Kolen Centrale [1967] 1 AC 361, at page 398).*

A notice of termination is unlikely to be valid where it purports to terminate the contract while simultaneously continues to allow the party to enjoy the benefits of the contract (*Leofelis SA v Lonsdale Sports Ltd [2008] EWCA Civ 641*).

Generally, unless specifically stated in a contract, there is no requirement for a party to act reasonably when exercising an express term to terminate a contract (*Financings Ltd v Baldock [1963] 2 QB 104*). Where a contract does not contain an express provision relating to termination, a party wishing to terminate would need to adhere to the principle of 'reasonable notice'. Reasonable notice does not play a significant role in franchising agreements, because they are almost always fixed term and will very often provide express contractual rights to terminate, thereby cancelling out the requirement to terminate by 'reasonable notice'.

Nonetheless, terminating by reasonable notice become relevant when a franchise agreement has expired, but the parties continue trading as though the contract were still in existence. This is known as 'holding over'. Where these circumstances exist, and the franchisor wishes to end such a state of affairs, the franchisor must adhere to the principle of 'reasonable notice'.

The courts have established that the length of reasonable notice required, in order for a franchisor to successfully terminate the 'holding over' period, will depend on the circumstances of an individual case, and subject to those circumstances; the length of reasonable notice is likely to be somewhere between three months and one year.

Overall, reasonable notice is generally not required in the context of a franchise agreement, because they are always fixed-term and will almost always contain express provisions that cover termination. It only becomes relevant where the franchisor wants to end the agreement 'holding over'. In such a situation, no contract terms exist, so it is up to the common law to determine how the termination is to be executed.

Immediate Termination Without Notice

The common express terms of immediate termination in both franchise agreements and distribution agreements are late fees, material breaches and impending or actual insolvency of a contracting party.

At common law, most material breaches also give the aggrieved party the right to terminate the contract. Where a material breach has led to termination, this is generally referred to as a repudiatory breach (*Heyman v Darwins Ltd [1942] AC 356, at page 397*).

There are four triggers for a right to terminate at common law:

1. Breach of a condition

The main consideration of what is regarded as a condition is whether the parties must have intended to confer that right for that breach.

2. Repudiatory breach of an intermediate term

An intermediate term is between a warranty and a condition. Whether breach of an intermediate term justifies termination depends on the breach, not on the term. If some of the possible breaches would deprive a party of substantially the whole benefit of the contract, but not all, the term is probably intermediate. When considering this, the questions usually raised are how much has already been received? What loss has the breach caused so far? How has it affected the value of future performance? Will the breach be repeated, continued or remedied? What loss will be averted by termination? All this must be considered at the time of termination (*Telford Homes (Creekside) Ltd v Ampurius Nu Homes Holdings Ltd [2013] EWCA Civ 577).* Whether termination is justified by that breach is judged at the time of termination, not when the contract was first entered into or when the breach occurred (*Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd [1961] EWCA Civ*).

3. Renunciation

Renunciation occurs when one party demonstrates its intention not to perform or expressly states that it will be unable to perform its obligations under the contract in a material respect. The renunciation can be made in words or by conduct.

4. Impossibility

This arises when a party cannot perform its obligations under the contract in some material way. This can arise through default of its own or by the other party or where the other party has rendered it impossible to fulfil the contractual obligations.

More recently, the Court of Appeal (obiter) has suggested that bribery is considered a repudiatory breach by the bribing party, which,

on discovery, the other party may accept as bringing the contract to an end. If one party bribes another's agent after contract is made, the aggrieved party may terminate (*Tigris International NV v China Southern Airlines Company Ltd [2014] EWCA Civ 1649*).

Where there has been a repudiatory breach, the right to terminate will automatically arise. The party which is in breach may convince the terminating party from affirming the contract, but it cannot force it to do so (*Buckland v Bournemouth University Higher Education Corp [2010] EWCA Civ 121*).

Insolvency

There is, to date, no law preventing franchise agreements from including a clause permitting the franchisor to terminate the contract upon the franchisee becoming insolvent. The right to terminate under insolvency must however, be contained within the contract, it is not granted under common law. Therefore, termination is an option for the franchisor where the franchisee is insolvent provided such an option is included in the contract. However, termination clauses relating to insolvency have become an increasingly common topic of discussion, and voices in favour rendering them illegal are becoming louder.

In England, issues relating to insolvency are primarily addressed by both the Insolvency Act 1986 (IA 1986) and the Insolvency Rules 1986 (SI 1986/1925). These sources of law treat the concept of insolvency as being where a party is 'unable to pay its debts'. This is a question of fact, and the subsequent guidelines are normally followed when determining whether a party is insolvent:

- The company has not paid, secured or compounded a claim for a sum exceeding £750, which is due to a creditor, within three weeks of having been served with a written demand in the prescribed form (known as a statutory demand).
- A creditor has unsuccessfully attempted to execute a judgment against the company.
- It is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due (the cash flow test).
- It is proved to the satisfaction of the court that the value of the company's assets is less than its liabilities, taking into account contingent and prospective liabilities (the balance sheet test).

Special consideration is given to contracts made on or after 1 October 2015 and which relate to the supply of essential services such as IT or utilities. Generally, a supplier cannot enforce some insolvency-

related terms, including termination rights, once the company it is supplying enters administration or a company voluntary arrangement (**CVA**) takes effect in relation to it (section 233A, IA 1986, inserted by the Insolvency (Protection of Essential Supplies) Order 2015 (SI 2015/989)).

Section 233A does not prevent a supplier from exercising termination rights if the company it is supplying becomes subject to an insolvency procedure other than administration or CVA (section 233A(2), IA 1986). A supplier may also terminate a contract in the period leading up to an administration or a CVA.

A supplier whose termination rights are restricted by section 233A may still terminate the contract in certain circumstances, for example, with consent from the administrator or the supervisor of the CVA, or from the court (section 233A(3)-(4), IA 1986).

Exclusivity Clause

Parties to a distribution agreement will normally insert exclusivity clauses into their contracts with the effect of limiting the producer to supplying goods to a sole distributor within the boundaries of a specified area. This type of arrangement is made for exploiting a product within a new market. In order to exploit the product with efficacy, the supplier will take similar steps to what the master franchisor takes when seeking to expand into a new country (see section on this in chapter dedicated to franchising). Namely, the supplier will seek out a distributor with a good grasp of how local consumers behave, as well as having a strong understanding of the method in which the local economy functions.

For the sake of clarification, consider this scenario: Company A, the producer, enters into a distribution agreement with Company B, the distributor. This agreement includes an exclusivity clause, which stipulates that Company B will be the sole distributor of Company A running shoes within the boundaries of greater London. However, Company A may have a simultaneous agreement with Company C, which stipulates that Company C is the sole distributor of Company A running shoes in the rest of England i.e. the effect of the exclusivity clause is that Company B cannot distribute Company A running shoes in the territory ascribed to Company C, which in this case is England minus greater London, and vice versa. In addition, Company A has the benefit of channelling the sales of its running shoes through two

well-established British retailers which have very good understanding on how English consumers behave.

As an alternative option to an exclusivity clause, a supplier makes a 'sole distribution' arrangement with a distributor. This type of arrangement has the same features as an exclusive distribution except for one key difference. While an exclusivity clause has the effect of constraining the supplier to channelling all of its sales in a specified area through the distributor through which it is in a contract, a contract for sole distribution allows room for the supplier to sell to consumers in the specified area directly. Therefore, this is a more favourable option where the supplier is operating in a territory that it already operates in, or that it already understands very well. To refer back to the example used above, this type of arrangement would suit Company A when it operates in Germany and Austria, as it does not require a third party to act as a mediator between itself and its consumers because it already has the requisite level of experience and understanding of operating on the German and Austrian markets.

Furthermore, a non-exclusive distribution agreement operates to allow the supplier to act freely of any restrictions on to whom and where it can sell its products. In other words, under this arrangement Company A could simultaneously contract both Company C and Company B to resell in greater London, at the same a time as Company A sells directly to consumers in the area itself.

Selective distribution is a viable option for a supplier to pursue where it produces commodities, which require an enhanced level of know-how in relation to making a sale and to offering post-sale customer support. This kind of distribution agreement is rarer, because it is only an option to a specific group of suppliers, specifically those producing commodities for the cosmetic, pharmaceutical and electrical goods industries. Thus, it is unlikely that Company A would have such a distribution agreement at its disposal, although perhaps a chemical company.

Duration of the Contract

Distribution agreements may vary significantly in terms of contract duration. It is in the discretion of the parties, to an agreement of this nature, to tailor the contractual duration of their legal relationship to suit their specific needs. Some distribution agreements may exist indefinitely, therefore they will continue to exist until they are terminated by reasonable notice. Meanwhile, other distribution agreements

may be born out of a fixed term contract, whereby they will automatically expire once the fixed period has ended. Overall, there are no specific rules in place to determine how long, or short, a distribution agreement must be, thus the parties to a distribution agreement are allowed a great deal of flexibility. This feature allows distribution agreements to be easily distinguished from a franchising agreement (see above section on franchising), because in these types of agreements, both parties are contracted into a fixed term period.

Termination Clause and Minimum Target

A producer may insert a minimum sales target clause into a distributorship agreement contract to ensure that the distributor meets the supplier's business objectives, such as meeting sales targets in the relevant market or buying from the supplier the quantity of produce contracted to buy. The consequences of the distributor's failure to meet the minimum targets will be clearly accounted for in the terms of the contract. Where the distributor is a sole or exclusive distributor, the supplier may impose terms, which allow it, upon failure of the distributor to meet the minimum targets, to supply directly to consumers in the distributor's area, or to enter into distribution agreements with other distributors in the relevant area.

However, the most extreme of consequences could be termination of the contract altogether. If the contract on which the distribution agreement hinges includes clear terms that indicate to the supplier's ability to terminate the contract at will on the grounds of the distributor's failure to meet the supplier's demands, then they will be entitled to do so. There is no provision in English law, which prevents an express contract term of this nature from coming into existence and of becoming legally enforceable.

Revocation of Termination Notice

A termination notice cannot be revoked once it has been served. The contract cannot be revived — even where notice to withdraw the termination notice is sent a mere one hour after notice to terminate has been served (*Riordan v War Office [1959] 1 WLR 1046, Diplock J*) or a day (*Sothern v Franks Charlesly & Co [1981] IRLR 278*).

Effect of Termination

For termination both under contractual termination clauses, and at common law, the contract still exists and has a legal effect. Terminating the contract does not undo the contract as if it had never existed (*State*

Trading Corp of India Ltd v M Golodetz & Co Inc Ltd [1989] 2 Lloyd's Rep 277).

Stock After Termination of the Contract: Rights and Obligations of the Parties

Stock, which ultimately forms the central pillar of any distribution agreement, continues to be a core feature of post-termination protocol. The consequences that termination may have for stock very much depend on what the parties to a distribution contract have agreed, and therefore consequences may vary from case to case.

One common arrangement regarding stock, following termination, involves giving the distributor a specified period in which to continue selling the stock. At the end of this agreed period, the distributor will normally be compelled to return the left-over stock to the supplier. The justification for such an arrangement lies in the presumption that sapping a distributor of stock so suddenly could have the adverse effect of unjustly crippling its finances, thereby rendering it unstable.

Moreover, the procedure of returning stock could take place without repayment, perhaps having the effect of resulting in the distributor sustaining substantial financial losses. With such a possibility on the horizon, a distributor will merit, on moral grounds, the chance to enter into a grace period (which could be seen as a period of transition), to permit it to plan for any challenging scenarios it may have to confront because of a supplier deciding to terminate.

Prior to arranging for stock to be sold off by the distributor, or returned to the supplier, both parties to a distribution agreement must consider whether an 'option-to-buy' clause exists in the contract. Often, an option-to-buy clause will permit the supplier to purchase from the distributor the stock, which was not sold by the time of the termination.

A supplier will trigger the option-to-buy clause where there are practical benefits to be made. Such practical benefits may arise in the following scenarios: where a supplier is moving into the territory in which the distributor is operating, or if the supplier plans to re-sell the stock to another distributor in the same territory. Equally, the distributor may welcome the triggering of an option-to-buy clause because it may view such a clause as an opportunity to shift the remainder stock.

Franchise agreements differ as the franchisee do not hold franchisor's 'stock' as such. Franchisees will either purchase their own equipment which is synonymous with the franchisor's business or hire the

equipment directly from the franchisor. Where this is the case, the franchisor under express terms of the contract can usually elect to purchase back the equipment of the franchisee business or if the equipment is leased, then the franchisee must return these immediately on termination.

Step-In

A unique provision which is found under franchise agreements but will not be found under distribution agreements is a 'Step-In' provisions. It is common to have express step-in rights for a franchisor to enter the franchisee's premises in order to operate the franchisee business. This is of course subject to limitations. Where a franchisor is forced to 'step-in' post termination, a franchisee will usually be liable to pay consideration to the franchisor and the calculation of the consideration will be expressly set out within the franchise agreement. This is salient for franchisors as the business reputation is at stake. Step-in provisions are common to allow franchisors the ability to apply 'damage control' where necessary.

Survival Clauses

Whether a contractual obligation is intended to survive termination is a question of contract interpretation in each case (*Involnert Management Inc v Aprilgrange Ltd [2015] EWHC 2225 (Comm) paragraphs 172 to 174*). Examples of survival clauses are restrictive covenants, indemnities, confidentiality, intellectual property rights and dispute resolution. Unless the contract specifies otherwise, these can survive termination indefinitely. This can be particularly important for franchise agreements as the franchisee would have had access to a substantial amount of the franchisor's know-how and intellectual property which will need to be well protected after termination.

Compensation

Under the Regulation which implement the European Agency Directive (EC/86/653), compensation or an indemnity payment is payable to commercial agents on termination of commercial agency agreements. Unfortunately, there is no comparable directive which extends to distribution and franchise agreements

In the UK, no compensation or indemnity is payable to a distributor on termination of the distribution agreement. Consequently, distributors are not well protected by the law as they are in certain other EU member states. This has the effect of granting suppliers a significant

amount of power, as terminating a distribution agreement will not result in any loss for the supplier in itself.

Even though the distributor has no right to claim compensation or indemnity for termination alone, the distributor may be able to claim damages where the agreement is terminated in breach of the agreement, under general contracting laws. Thus, termination of a distribution agreement will not render the terminating party liable for compensation or indemnity, however termination that falls outside what is allowed under general contracting laws, may induce the terminating party into a state of liability for his otherwise lawful actions. Overall, termination will not generally provoke any grounds for claims for compensation or indemnity to arise, and the supplier should not encounter too much difficulty when they wish to terminate a distribution agreement.

Damages

How much a terminating party can recover on damages for loss will depend on whether the breach was repudiatory or not. A party to a contract which has breached that contract is liable to pay damages — this arises whether the right to terminate arose from express provisions under the contract or at common law.

Damages are calculated by putting the terminating party into a position if there had been no breach. The losses which are awarded are the losses which were caused as a result of the breach — not as a result of the termination.

If the breach is repudiatory, the aggrieved party can recover further losses. If it was not repudiatory however, loss of profits is not usually awarded.

This is the effect of several Court of Appeal decisions from the 1960s. (*Financings Ltd v Baldock 1963 2 QB 104; Brady v St Margaret's Trust [1963] 2 QB 494; Anglo-Auto Finance Ltd v James [1963] 1 WLR 1042 and United Dominions Trust (Commercial) Ltd v Ennis [1968] 1 QB 54.*)

The Court of Appeal had decided that in those cases, the loss of future profits was caused by the terminating party exercising its right to terminate, not by the breach itself. This is not strictly applied however, ultimately it may be a question of contract interpretation for the courts to award damages for loss of the terminated contract when the termination was triggered by a non-repudiatory breach.

In 2009, Burton LJ said "In my view it is wrong to treat the right

to terminate in accordance with the terms of the contract as different in substance from the right to treat the contract as discharged by reason of repudiation at common law" (*Stocznia Gdynia SA v Gearbulk Holdings Ltd [2009] EWCA Civ 75*). The Court of Appeal in that case held the parties had intended the termination clause to identify, as between the parties and for that transaction, which breaches should justify both termination and a claim for damages for loss of the contract. Ultimately it will be a question of interpretation for the courts.

Chapter VII

TERMINATION OF FRANCHISING AND DISTRIBUTION AGREEMENTS IN SPAIN

by *Fernando Sales Bellido* and *María Dominguez Delgado*
(coauthor for franchise agreement) (*)

(*) *Lawyers in Spain, Barcelona - f.sales@fabregat-perulles-sales.com*

I.
THE DISTRIBUTION AGREEMENT

1. Regulation: Atypical Agreement and Analogical Application of the Laws Regulating Other Agreements.

1.1. Regulations.

The Spanish Law does not have a specific norm regulating the distribution agreement. This type of agreement is governed by the provisions that, in general terms, regulate contracts. These regulations are basically included in articles 1088 et seq. of the Spanish Civil Code (CC), and articles 2 and 50 of the Spanish Code of Commerce (CoC) for commercial agreements.

There have been legislative initiatives to try to solve this regulatory gap, but none of them materialized. One of them is the Draft Bill for Distribution Agreements of 2011 (1).

More recently, one of the proposals for a new Code of Commerce introduced a particular section devoted to commercial distribution. However, during the processing of the project that regulation was removed.

Nevertheless, there is an exception for this regulatory gap. In the year 2011 the first additional provision for Act 12/1992, of 27 May, on the Agency Agreement (hereinafter AAA), was introduced, by way of which the Spanish legislator regulated the distribution agreement for motor vehicles (2). However, it has not entered into force as of yet.

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(1) Official Gazette of the Spanish Parliament of 29 June 2011 (*http://www.congreso.es/public_oficiales/L9/CONG/BOCG/A/A_138-01.PDF*).

(2) 1. Until a Law regulating distribution agreements is approved, the legal framework for the agency agreement provided in the hereby Law will be applicable for distribution agreements for motor and industrial vehicles, by way of which a natural or legal person, called "the distributor", becomes bound vis-à-vis another one, "the supplier", on a continuous or stable basis and for consideration, to promote commercial acts or operations for these products for and on behalf of the owner, as an independent vendor, assuming the risk of such operations.

2. In the absence of an expressly applicable Law, the different modalities of distribution agreements for motor and industrial vehicles of whichever type will be regulated by the provisions of the hereby Law, the precepts of which have a binding force.

In spite of all these legislative initiatives and even published norms

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3. Any agreement which grants the supplier the power to unilaterally modify the essential contents of these contracts shall be void, and in particular when the modification regards the complete line of products and services under the agreement, the business plan of the distributor, the investments and repayment terms, the fixed and variable remunerations, the prices of the products and services, the general sale conditions and after-sales guarantee, the commercial guidelines and the distributors' selection criteria.

4. The distributor is bound to make only those specific investments which are needed for the execution of the agreement and appear expressly and distinctively stated in the agreement or its amendments, and only when it provides the period in which each of them will be considered paid off.

For these purposes, a specific investment is an investment that cannot be used in a real and effective way for purposes other than the execution of the distribution agreement.

5. When the supplier requires from the distributor a minimum purchase of the products under the agreement with the aim of having a stock calculated according with the commercial objectives, the distributor will have the capacity to return the purchased products that have not been ordered by the customers, after sixty days from their acquisition. In this situation, the supplier is bound to buy back from the distributor the returned products in the same conditions in which they were bought.

6. In case of termination of the agreement, either by the end of its term or by any other cause, the distributor will have the right to receive the following amounts as remuneration or compensation for the concepts indicated below:

a) The amount corresponding to the value of the specific investments pending recoveryat the moment of the termination of the agreement.

b) A compensation for customers that in no case can be less than the average annual value of the sales made by the supplier to the distributor during the last five years in which the agreement was in force, or during all its term in case it lasted less than that.

c) The compensations for the workers dismissed by the distributor because of the termination of the agreement.

d) Likewise, in case of termination of the agreement, the supplier will be bound to acquire from the distributor all those goods held by him at the same price they were sold.

The previous compensations are established notwithstanding the compensation rights in favor of the corresponding party for damages caused by breaches of contract incurred by the other part, and any agreement contrary to this provision shall be void.

7. The supplier cannot deny his approval for the total or partial transfer of the distribution agreement for motor and industrial vehicles if the assignee undertakes in writing to keep the management, structure and resources that the assignor had for the distribution activity.

8. The competence to hear all matters arising from the commercial distribution agreement for motor and industrial vehicles lies on the competent Judge at the place of business of the distributor, and any agreement contrary to this provision shall be void.

(which nonetheless have not entered into force), the fact is that today, notwithstanding the relevance and high level of conflict the distribution agreement generates, it still does not have a specific regulation.

Nevertheless, there are scattered norms that directly or indirectly affect the distribution agreement (3).

1.2. Concept.

This legislative gap has been traditionally compensated by case law and academic legal literature, which has repeatedly defined the distribution agreement as an atypical, consensual, bilateral, and complex agreement, "*by which the distributor acquires the goods that he tries to introduce into the market, and then handles the difference between the cost price and the transfer price, in order to obtain a benefit once the expenses are deducted (Judgments of 8 November 1995 [Collection of Law Reports No. 1995, 8637], of 17 May 1999 [Collection of Law Reports No. 1999, 4046], and of 30 October 1999 [Collection of Law Reports No. 1999, 8169], among others). It is a complex fixed-term commercial agreement, where the distributor has a special consideration or relevance (technical or organizational capacity, etc.), thus generating an intuitus personae (Judgments of 22 March 1988 [Collection of Law Reports No. 1988, 2224], of 28 February 1989 [Collection of Law Reports No. 1989, 1409], and of 21 November 1992, among many others). The distributor acted on his own name and behalf, acquiring by means of purchase the products of the licensor, among other particulars that do not need to be mentioned here (but can be seen in Judgments such as those of 17 May 1999 [Collection of Law Reports No. 1999, 4046] and*

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(3) Act 7/1996, of 15 January, on Retail Trade Regulation; the Consolidated text of the Law of Consumers and Users approved by Legislative Royal Decree 1/2007, of 16 November; Act 15/2007, of 3 July, on the Defense of Competition; EC Regulation 2790/1999 of the European Commission, of 22 November 1999, on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices; EC Regulation 1400/2002 of the European Commission, of 31 July 2002, on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices in the motor vehicle sector; EU Regulation 330/2010 of the European Commission, of 20 April 2010, on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices; and EU Regulation 461/2010 of the European Commission, of 27 May 2010, on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices in the motor vehicle sector.

30 October 1999 [Collection of Law Reports No.1999, 8169], in a relationship that has to be governed by the system agreed upon (articles 1255 and 1091 of the CC [LEG 1889, 27]), and integrated according to the provisions of articles 1258 of the CC and article 57 of the CoC (LEG 1885, 21)" (4).

1.3. Analogical application of the AAA.

1.3.1. Preliminary considerations.

Considering the features defining the distribution agreement and its basic structural elements, the Spanish judicial doctrine and case law have been applying, for some very specific aspects, the AAA by way of analogy.

However, we must point out that, more recently, these decisions have made an effort to make clear that the application of the AAA to the distribution agreement, even by way of analogy (5), is not and should not be automatic. This application must be done not only cautiously, but also analyzing every single case, and provided that the same *ratio* (6) occurs in the circumstances regulated in the law and the circumstances of the case considered. Finally, we want to point out that the most recent cases avoid "the analogical application of the AAA", considering this law as a norm inspiring the solutions that can be given to the controversies arising around the distribution agreement (7). In

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(4) See, for all, Judgments No. 924/2005 of the Supreme Court (Civil Chamber, Section 1), of 2 December. Collection of Law Reports No. 2005/1018.

(5) Judgment of the Supreme Court of 10 July [Collection of Law Reports No.2006, 9425]

(6) Article 4 [Analogy and supplementary character of the Civil Code]

"1. Where the relevant rules fail to contemplate a specific case, but do regulate another similar one in which the same *ratio* is perceived, the latter rule shall be applied by analogy."

(7) See Second legal reason for decision, judgment of the Supreme Court No. 404/2015, of 9 July, point 4 of the Judgment being analyzed, which states:

"First, the precedents in this court have already highlighted the inappropriateness of an exact or automatic application of the legal framework of the agency agreement to the distribution agreement, reaching not only the compensation for customers, but also other legal provisions, such as the one related with the obligation of previous notice in case of termination of an open-end agreement" (Judgment of the Supreme Court of 8 October 2013, No. 569/2013 (Collection of Law Reports No. 2013, 8002), and 22 June 2010, No. 378/2010 (Collection of Law Reports No. 2010, 5408))".

fact, as we will see later, there are considerable doubts over the existence of the same *ratio* in the agency agreement and the commercial distribution agreement, as article 4 of the CC requires in order allowing the use of the analogy to be in accordance with the provisions thereof.

Likewise, it should be pointed out that not all the AAA is considered able to be applied analogically and/or be a source of inspiration to govern the relationships and settle the disputes arising around the distribution agreement. The aspects and matters where that application materializes are the following:

(i) Termination of the agreement

(ii) Previous notice of termination and good faith

(iii) Compensatory consequences of the termination of the agreement. Losses and clientele

The analysis of these aspects will be duly exposed in the following sections of this work.

1.3.2. Analogy. Requirements for its application.

As we said above, case law considers the analogical application of the AAA in specific circumstances, but not in a general and automatic way.

This nuance, which of course is trivial, has its origin and *raison d'être* in the opinion of an relevant part of the doctrine, which defends that there is not legal reason justifying that analogical application, given that the agency agreement and the distribution agreement do not have the same *ratio*, as required by article 4.1 of the CC to allow resorting to analogy.

Traditionally, the precedents (8), in order to authorize the use of the analogy, have required the occurrence of the following circumstances:

a) The norm should not consider a specific circumstance, but a similar one;

b) The same *ratio* should be perceived in both; and

c) They should not be Criminal Laws, or laws constituting sanctions that entail loss of rights.

In the case we are analyzing, it is evident that (a), there is no sectorial norm, and (c), it is not a criminal or sanctioning law.

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(8) For all, see the Judgment of the Supreme Court of 11 May and 21 November 2000.

Thus, the requirement for the same *ratio* that the legal situations we are analyzing have to fulfil is the issue that can bring more complexity and shades. In the following section, we will study this in more depth.

1.3.3. Same *ratio*?

First, it is important to point out that there has been a traditional division between the Courts and the legal doctrine in this respect. Moreover, in this case, case law has shown its unsteadiness, and its criteria have suffered variations that have affected, in the majority of cases, to the legal ground that has provoked the admission or rejection of the claim for compensation for clientele by the distributor. Although the analogical application of the Ais wider and comprises other institutions of the agreement, the compensation for clientele has in some way been the center of an important number of legal decisions which have devoted their *ratio dicidendi* to justifying the reason for their approval or refusal of the application of the AAL.

In order to check the occurrence of the same *ratio* in both figures, it is essential to carry out a comparative study of the similarities and differences between the agency agreement and the distribution agreement.

Essentially, following the system proposed elsewhere (9), the similarities and differences between them would be the following:

1. *Similarities*

1. They both are collaboration agreements.

2. The have both have an *intuitu personae* nature.

3. They are stable fixed-term agreements of continuing performance, either open-ended or for a fixed term.

4. They are commutative contracts for valuable consideration.

5. They are commercial agreements.

6. They do not require a specific form to be valid.

7. They are definitive, and no further act is needed for their execution.

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(9) See Foncutberta Llanes, Javier, *El contrato de distribución de bienes de consumo y la llamada indemnización por clientela*, Marcial Pons, Esade, 2009, pages 237 et seq.

1.1. *Differences*

In front on the similarities we have listed, there are some elements that differentiate one figure from the other. They are, essentially, the following ones:

1. The agent acts on another's behalf, while the distributor acts on his own behalf.

2. The distributor only hires, while in the case of the agency, the power to hire is exceptional, being the agent´s main duty the promotion of businesses on the owner's behalf.

3. The clientele generated by the agent will be integrated into the manufacturer's clientele, which does not seem to be the case when it comes to the distributor.

4. The degree of autonomy is also different, the distributor having a much higher level of autonomy.

5. The same thing can be said regarding their independence. The distributor is completely independent.

6. The risk assumption in the operations is also different. The agent, unless otherwise agreed, does not assume risks, while the risk assumption is essential in the distributor, who, in every case, acts *nomine propio*. This means that the position of both of them regarding their responsibility before third parties is also different.

7. The applicable legal framework is also different. The AAA stipulates a mandatory set of rules, while the regulations applicable to the distribution are essentially dispositive regulations.

8. Both the concept and the structure of the remuneration also show important differences. The agent will receive a commission or remuneration from the Principal, while the benefit of the distributor will be given by the difference between the purchase and sale prices of the product.

9. The investment made by the agent and the distributor is also different in all their aspects.

In conclusion, taking the previous notes in consideration, the analogical or inspiring application of the AAA to the settlement of the distribution agreement will depend on the study of each particular situation, thus justifying the criteria of the precedents explained above, that is, the casuistic and not automatic application of the AAA.

2. Non-competition clause.

2.1. Definition.

Traditionally, Spanish legal doctrine have considered the non-competition clause as an obligation to "refrain from doing", given that, in short, the consideration means not carrying out a material or legal act.

Thus, the typical content of the clause is integrated in the limitation accepted by the debtor, in the sense that he will not be allowed to hire a similar consideration with any other third party. Prior to the termination of the non-competition agreement, this consideration, being in every case legal, can be freely agreed upon. Here is how the conventional non-competition agreement is different from the legal prohibition to act or make.

Moreover, it is said that by the fulfillment of the non-competition clause one of the economic functions of the agreement is achieved, which is that the clause regulates the ordinary legal framework of the conventional agreement to which it is attached, so the breach of that non-competition agreement can give ground to the termination thereof.

2.2. Normative fit. Lawfulness.

The non-competition agreement has its normative fit in the provisions of article 1255 of the CC "*The contracting parties may establish any covenants, clauses and conditions deemed convenient, provided that they are not contrary to the laws, to morale or to public policy*", which embody the principle of contractual freedom, which in turn affects both the form and the contents of the contract.

On the other hand, the principle of freedom of form is embodied in article 1254 of the CC ([10]), by virtue of which the agreement exists for the Law from the moment in which the consent to the creation of an obligation is given.

We have to add to that freedom of form the will-over-form

([10]) Article 1254

The contract exists from the time where one or several persons consent to bind themselves vis-à-vis another or others to give something or to provide a service.

principle that governs Spanish Law which is declared in articles 1278 of the CC (11) and article 51 of the CoC (12).

Both principles, which govern the Spanish Contract Law, establish that the entry into force and validity of the non-competition agreement do not need to have a specific (written) form. Notwithstanding that, article 1279 of the CC (13) gives the power (not subject to the statute of limitations) to the contracting party to demand from its counterpart the written realization of the clause. Thus, the form of the contract is *ad probationem* and not *ad solemnitatem.*

As far as the contents are concerned, the limits of the non-competition clause will be given by the proscription of situations against the fair balance between the parties, the defense of competition, public interest, mandatory law, etc. which we will refer to below.

2.3. Ancillary nature.

The non-competition clause is ancillary to the main agreement in which it is introduced, as part of the agreement itself or as a separate agreement, for it can exist as an autonomous agreement, and to a certain extent it models it. That is why it is said that the non-competition agreement has an economic and legal function that complements the main relationship to which it is introduced.

This ancillary nature binds the life of the clause to the fluctuations experienced by the main agreement. We would like to point out, by way of example, provisions of article 1155 (14) regarding nullity, of

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(11) Article 1278

Contracts shall be binding, whatever the form under which they have been entered into, provided that they meet the essential conditions for their validity.

(12) Article 51

Business contracts shall be valid and binding and actionable in court whatever their format and the language in which they are entered into, whatever their class and the quantity they concern, provided their existence is proved by any of the means established in Civil Law.

(13) Article 1279 [On the form of the contract]

If the law should require execution of a public deed or another special form for the obligations inherent to a contract to be effective, the contracting parties may compel each other reciprocally to fulfil such form from the moment when consent has been given and the remaining requirements necessary for its validity are present.

(14) Article 1155 [Nullity of the penalty clause and nullity of the obligation]

The nullity of the penalty clause shall not entail the nullity of the principal obligation.

article 1190 ([15]), on the remission of the debt, or of article 1207 ([16]), on novation, all of them from the CC.

Given its ancillary nature, the clause will be part of a mixed contract, but it will not constitute a complex contract, given the existence of only one legal relationship, although, as it is said, it will be modified in its basic modality by the addition of the non-competition clause.

Anyway, it is important to point out that, despite this ancillary nature, the Supreme Court, in its Judgment of 29 January 1955, declared that the non-competition clause has the same level of importance as the principal obligation, so, as we said above, its non-compliance will cause a definitive breach, as it is an essential part of the consideration, and in consequence, it could provoke the termination of the contract.

2.4. Autonomy.

Some authors defend that the non-competition clause keeps certain autonomy regarding the main contract, which is evident in two ways:

(i) Regarding its purpose which is separate and particular with respect to the main contract.

(ii) Regarding its term and duration, which can be different from the main contract, and, in particular, when the main contract is performed in one act (as opposed to a continuing-performance agreement). This last point, however, is not unanimously agreed upon among legal doctrine. Despite this fact, the Supreme Court seems to have accepted it, although tacitly, in its judgment of 18 March 1966, when it ruled in favor of the validity and entry into force of a clause that banned the sale to third parties of a product (a record player), which was the object of the sale and the main contract, during a period following the performance of the sale.

([15]) Article 1190 [On the remission of the principal debt and ancillary obligations]

Remission of the principal debt shall extinguish ancillary obligations thereof; but in the event of remission of the latter, the former shall subsist.

([16]) Article 1207 [Subsistence of the ancillary obligations in case of novation]

Where the principal obligation should be extinguished as a result of novation, ancillary obligations may only subsist to the extent that they benefit third parties who have not given their consent.

The concession agreement is excluded from this autonomy framework, for it requires, as a typical and defining characteristic of this kind of contract, the exclusive reciprocity of the parties.

2.5. Defining characteristics of the clause.

The most authoritative academic doctrine (17) has defined the following characteristics of the non-competition clause:

(i) *It limits contractual freedom*: This limitation must be coherent with articles 1271 to 1273 (18), and the subject matter of the contract must be legal, possible and determined.

(ii) *It has a conventional origin*: Articles 1089 (19), 1255 (20), and 1091 (21), of the CC, state that the contract is a source of obligations and a law for the parties, which results in the necessity of distinguishing its nature from the non-competition that arises from a particular sectorial precept or norm, such as those regulating industrial and intellectual property rights and trademarks rights.

(iii) *It has a pecuniary content*. The clause, or better its effects, has an economically assessable content.

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(17) Peña Romero, Karin, *El pacto de exclusiva*, Aranzadi, 2012, pages 86 et seq.

(18) Article 1271 [Purpose of the contracts]

All things which are not beyond the bounds of commerce between men may be the subject matter of a contract, even future things.

Notwithstanding the foregoing, no contracts may be entered into regarding the future inheritance other than those whose purpose is to perform the division of an real estate *inter vivos* and particular arrangement, in accordance with the provisions of article 1056.

Likewise, all services which are not contrary to the laws or to good customs may constitute the subject matter of a contract.

Article 1272 [Impossible things or services]

Impossible things or services may not be the subject matter of a contract.

Article 1273 [Determination of the contract]

The subject matter of any contract must be a thing determined as to its species. Indetermination as to amount shall not prevent the existence of a contract, provided that it is possible to determine it without the need for a new agreement with the contracting parties.

(19) Article 1089 [Sources of the obligations]

Obligations arise from the law, from contracts and quasi-contracts and from unlawful acts or omissions or those in which there is any kind of fault or negligence.

(20) *See ut supra,* point 2.1.

(21) Article 1091 [Contractual obligations]

Obligations arising from contracts have the force of law between the contracting parties and must be complied with in accordance with the provisions thereof.

(iv) *The non-competition agreement is not given for granted.* The agreement has to be proven, what can be done by any means admitted by law. This need for evidence should not be confused with a requirement for the agreement to be in writing. The Judgment of the Supreme Court of 15 January 2008 acknowledges the existence of a verbal non-competition agreement.

So, the matter is reduced to a question of giving evidence of the existence of the agreement.

2.6. Subjective change in the non-competition agreement.

The possibility of the occurrence of a modification in any of the subjective elements of the non-competition clause presents some aspects that, given their interest, have received the focus of the scientific and legal doctrine.

Indeed, the positive or negative answer given to this question can be addressed from the consideration of the *intuitu personae* nature that some precedents give to the non-competition agreement. Although there is kind of a controversy around this, in order to find an answer, it can be useful to assimilate the actual *intuitu personae* obligation to the so-called strictly personal obligation.

So, if we consider that the non-competition agreement takes part in the *intuitu personae* nature (or, as it has been said, *intuitu instrumenti*), the lawfulness of the transfer of the contract or the transfer of the position of the parties in the contract in case of transfer of the company can be seriously put at risk.

It seems, however, that if the non-competition agreement is part of a commercial distribution agreement, the legal doctrine maintains, almost unanimously, that although that agreement has a trusting nature, it does not take part in the *intuitu personae* nature (22).

This seems to be the position of the Supreme Court, which, in its judgment of 14 July 1985, declared the validity of the subjective novation of the clause, both in cases of transfer of the position of the parties in the contract, and in cases of company sale.

However, the opinion of the Supreme Court has been unsteady regarding this respect. On the one hand, in its judgment of 17 May 1999, the Supreme Court decided that these agreements are in effect

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(22) Soto Alonso, Ricardo, *Tipología de los contratos de distribución comercial*, in *Los contratos de distribución*, various authors, La Ley, Madrid, 2010, page 61.

intuitu personae businesses, based on trust and highly sensitive to any breach, while on the other hand, the same Court ruled later in its judgment of 16 December 2005 that considering the agreement as *intuitu personae* depends on the declared will, the nature of the contract and the particular circumstances in which the legal act is carried out.

It seems that neither the precedents nor the academic doctrine show a unanimous opinion.

2.7. Limits.

The limits within which the non-competition agreement is bounded have been established by precedents and doctrine, given that, in contrast with other legal systems, the Spanish legal system does not have a particular norm or regulation devoted to the treatment of these limits.

Basically, we can list three types of limits to the liberty that article 1255 of the CC grants to the parties when setting the reach and contents of the non-competition agreement. Those three types of limit are the ones imposed on the duration, the space (territory) and the law (mandatory law) and public interest.

Finally, considering that the Spanish legal system lacks a specific sectorial regulation regarding this matter, and that most of the limits imposed to the commercial distribution agreements have their origin in the European competence laws, we will focus our attention on the particularities that the Spanish law has regarding this matter. The specificity and complexity emanating from this normative body coming from the European institutions make it recommendable to resort to the works developed specifically around this subject. That is why we will restrict ourselves to a brief reference to the aforementioned normative framework.

2.7.1. Temporal limit.

The first precedent that addressed this matter (Judgment of the Supreme Court of 29 October 1955) opted to consider the unimportance of the duration of the agreement. It declared that the specification in the contract of a maximum term for the duration of the agreement did not need to be necessarily observed.

Apparently, this situation seems to have been modified afterwards,

as the Supreme Court Judgments of 28 May 1966 and 21 April 1979 ruled that the agreement has binding effects only when it has no time or space limitations.

However, the matter can be solved considering the right of repudiation and abandonment at will that the parties of a bilateral open-ended contract based on trust such as the distribution agreement is entitled to. Indeed, the right of abandonment at will is sort of an exhaust valve in situations where, if that resource was unavailable, it could be liable to be considered perpetual, what contravenes the Spanish legal system (23) (24) (25). It is important to point out that in case of unilateral termination of the contract, this shall be done with strict respect for the duty of loyalty and the good faith principle (26), as we will study in points 4.3 and 5.2 of this work.

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(23) The Judgment of the Supreme Court of 9 October 1997 rules on this matter. See also infra point 3.

(24) The right of abandonment at will in a commercial context is expressly granted in articles 224 of the CoC (on the right of separation of the partners), and article 302 (on the hiring of the mercantile factor).

Article 224 [Bad faith of the partners]

In general or limited partnership companies formed for a indefinite term, if any of the partners demands the dissolution thereof, the others may not oppose this except in the event of bad faith by the party proposing this.

A partner shall be understood to act in bad faith when, by virtue of the dissolution of the company, he aims to make private profit that he would not have obtained had the company subsisted.

Article 302 [Termination of the agreement celebrated without a fixed term]

In cases in which performance of the agency does not have a set term, either of the parties may consider it to have expired, notifying the other one month in advance.

The factor or assistant shall be entitled, in that case, to the wage due for that month.

(25) Article 25 of the AAA, which is analyzed elsewhere in this work, can also be consulted around this topic.

(26) See the Judgment of the Supreme Court of Justice of Madrid, of 28 January 2015, which introduces the good faith principle in the concept of public interest:

"A prominent model of the principle that integrates the economic public interest is the general principle of good faith in hiring, expressly acknowledged today, as the Civil Chamber of the Supreme Court points out, in the Principles of the European Contract Act, which, in article 1:201, under the title "Good faith and Fair dealing", states that "each party must act in accordance with good faith and fair dealing".

The compliance with this good faith principle is specially mandatory when, in a particular hiring, there is a situation of imbalance, disproportion or asymmetry between the parties, given, in some cases, the nature as a consumer of one of the parties, or, in some other cases, because of the complexity of the purchased product and the different knowledge on it that the different contracting parties have.

In parallel with the right of abandonment, duty of loyalty, and good faith, the doctrine has more recently introduced the arbitration concepts of "optimal duration and reasonable duration" (27), in relation with the investments made, as well as the so-called *Recoupment Theory* (28), defined by Collins Hugh as parameters to fix the duration of the contract.

For an approach to the law of the European Union, we would refer to article 5 of Regulation 330/2010 of 20 April, on the application of Article 101(3) of the Treaty on the Functioning of the European Union (TFEU) to categories of vertical agreements and concerted practices (29), which is devoted to detailing the restrictions excluded from the exemption it addresses.

In any case, there is no doubt that, in situations as the aforementioned, keeping the good faith principle is a norm of public interest, what is connected with the public interest of the European Union, and, in relation with it, of the full session of the First Chamber of the Supreme Court. This assimilation cannot be ignored by this Chamber when ruling over the annulation or not of a decision, precisely for infraction of the public interest..."

(27) See García Herrera, Alicia, *La duración del contrato de distribución exclusiva*, Tirant lo Blanc, Valencia, 2006.

(28) Collins, Hugh, *The law of contract*, Butterworth, London, 1993, pages 129 et seq.

(29) Article 5

Excluded restrictions

1. The exemption provided for in Article 2 shall not apply to the following obligations contained in vertical agreements:

(a) any direct or indirect non-compete obligation, the duration of which is indefinite or exceeds five years;

(b) any direct or indirect obligation causing the buyer, after termination of the agreement, not to manufacture, purchase, sell or resell goods or services;

(c) any direct or indirect obligation causing the members of a selective distribution system not to sell the brands of particular competing suppliers.

For the purposes of point (a) of the first subparagraph, a non-compete obligation which is tacitly renewable beyond a period of five years shall be deemed to have been concluded for an indefinite duration.

2. By way of derogation from paragraph 1(a), the time limitation of five years shall not apply where the contract goods or services are sold by the buyer from premises and land owned by the supplier or leased by the supplier from third parties not connected with the buyer, provided that the duration of the non-compete obligation does not exceed the period of occupancy of the premises and land by the buyer.

3. By way of derogation from paragraph 1(b), the exemption provided for in Article 2 shall apply to any direct or indirect obligation causing the buyer, after termination of the agreement, not to manufacture, purchase, sell or resell goods or services where the following conditions are fulfilled:

2.7.2. Spatial limit.

i) Unilateral alteration

The spatial delimitation by means of the non-competition agreement is also one of its essential nature, and, as any other contractual and reciprocal covenant, it cannot be unilaterally modified, as Article 1256 of the CC (30) stipulates. Having said that, it is not an absolute prohibition, on the contrary, the strictness of that principle has been mitigated by precedents in some exceptional cases, justifying that alteration by the appearance, in the case considered, of objective causes (31).

It is clear that, in any case, these alterations are expressly prohibited if they can lead to situations of abuse, or if they can be fraudulently used to reach a (non-explicit) termination of the contract (32).

ii) Absolut territorial non-competition protection

By virtue of the provisions of article 101 of the TFEU, regulation 330/2010 and the directives regarding vertical restrictions (2010/C 130/1) of 19 May 2010 (33), it can be said that the absolute territorial protection (by direct or indirect restrictions) constitutes an especially serious restriction to free competition, so the general principle is the refusal to any clause of absolute territorial non-competition protection (34).

(a)the obligation relates to goods or services which compete with the contract goods or services;

(b)the obligation is limited to the premises and land from which the buyer has operated during the contract period;

(c) the obligation is indispensable to protect know-how transferred by the supplier to the buyer;

(d) the duration of the obligation is limited to a period of one year after termination of the agreement.

Paragraph 1(b) is without prejudice to the possibility of imposing a restriction which is unlimited in time on the use and disclosure of know-how which has not entered the public domain.

(30) Article 1256

The validity and performance of contracts cannot be left to the discretion of one of the contracting parties.

(31) See Appeal Judgment of Barcelona of 14 December 2004.

(32) See Judgment of the Supreme Court of 30 November 1999.

(33) *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:130:0001:0046:ES:PDF.*

(34) The Judgment of the European Court of Justice of 8 February 1990 totally rejects these behaviors.

iii) Active and passive behaviors

According to the provisions of Regulation 330/2010 (which, in its 3rd article establishes the limit for the exemption in the 30% of the market share that can be affected by the termination of the agreement in question), as well as the Directives regarding vertical restrictions, we can say that establishing a clause prohibiting passive behaviors (35) has been identified as a very serious infringement of free competition. The answer, however, is not the same in cases of prohibition of active behaviors (36), which have been effectively admitted in certain circumstances.

2.7.3. Public interest limit.

As we explained above, the parties are free to reach the agreements deemed suitable by them, with the only limit of respecting the law, the morals, and the public interest, as provided in article 1255 (37).

The Spanish law establishes the freedom of enterprise and trade as a fundamental value and right.

This right is materialized in article 38 of the Spanish Constitution (38), and in article 16 of the Charter of Fundamental Rights of the European Union, of 18 December 2000.

It is a commonly shared opinion that among the faculties of the free enterprise are the access to the market, the free exercise and the suspension of activities. In consequence, the free enterprise comprises

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(35) We understand as such those arising as an answer to orders not actively provoked, coming from individual customers, including the introduction of goods and services, the general advertisement or promotion activities in the media or the internet that reach to clients in areas exclusively designated to other distributors but which constitute a reasonable way to reach to potential purchasers outside those territories. See Peña Romero, Karin, *El pacto de exclusividad*, Aranzadi, 2012, page 147.

(36) We understand as such the approach outside the designated area towards customers within the exclusive territory of another beneficiary, by direct mail, visits, advertisement in the media and other activities specifically focused on this group of customers inside certain geographical area not included in the non-compete area. See Peña Romero, Karin, *El pacto de exclusividad*, Aranzadi, 2012, page 147.

(37) See above, point 2.1

(38) Article 38

Free enterprise is recognized within the framework of a market economy. The public authorities shall guarantee and protect its exercise and the safeguarding of productivity in accordance with the demands of the economy in general and, as the case may be, of its planning.

the freedom to manage and organize the means and forms of production.

From this point of view, we can point out that the norms on competition imposed by the TFEU appear as norms that regulate that liberty, imposing it as a social exercise, what somehow makes the tension between both systems evident.

Hence, in addition to the aforementioned norms of mandatory law (the acts against which are null and void by operation of law, by virtue of article 6.3 of the CC ([39])) and competition, the limit to the agreement is the public interest (in Spain ([40]) and in the European Union ([41])), a

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([39]) Article 6.3

Acts contrary to mandatory and prohibitive rules shall be null and void by operation of law, save where such rules should provide for a different effect in the event of violation.

([40]) For a concept of national public interest, see, among others, Decision of 4 March 2003 of the Supreme Court (Civil Chamber, Sole Section).

Thus formulated, the ground of opposition must be allowed, as it is understood that the rights of defense of the opposing mercantile party are violated and that they integrate the concept of public order of the forum, having specified the High Court that such concept, as a limit to the recognition and enforcement of the foreign decisions, has acquired a new dimension since the entry into force of the 1978 Constitution (Chronological Legislative Catalog 1978, 2836), in which, without a doubt, all the principles that inspire our constitutional order permeate, and, among them, especially, fundamental rights and public liberties, which have taken on a new dimension, thus acquiring a peculiar content impregnated by the requirements of the Constitution and, in particular, by the demands imposed by article 24 of the Spanish Constitution (Judgments of the Constitutional Court 112/93 [Constitutional Court Catalog 1993, 112], 153/93 [Constitutional Court Catalog 1993, 153], 364/93 [Constitutional Court Catalog 1993, 364], 158, 94 y 262/94, 178/95, 18/96, 137/96, 99 [Constitutional Court Catalog 1997, 99] and 140/97 [Constitutional Court Catalog 1997, 140] and 44/98 [Constitutional Court Catalog 1998, 44], among many others). It should be pointed out that it should not be forgotten that at the international level this concept currently has a clearly constitutional content, which is essentially identified with the constitutionally established rights and guarantees, and, in particular, with regard to the prohibition of defenselessness imposed by article 24.2 of the Spanish Constitution in relation to the acts of communication, it must be material, real and effective, not merely formal, and relevant only if the party is unjustifiably deprived of the opportunity to defend its respective procedural position, thereby giving rise to an irregularity which effectively undermines its rights and interests, and the Constitutional Court's interpretation is integrated, immediately and to the extent applicable to arbitration, by article 6 of the Rome Convention of 4 November 1950 (Chronological Legislative Catalog 1979, 2421), which, together with the International Covenant on Civil and Political Rights of 16 December 1966 (Chronological Legislative Catalog LR 1977, 893), establishes itself as a hermeneutical canon that integrates the content of

public interest that some authors have specified as "economic" public interest (42).

3. Contract period.

The duration of the distribution agreement is of considerable importance for the parties at the time of its performance. Indeed, the intrinsic characteristics of the "traditional" commercial distribution have required a stability and durability over which cooperation between manufacturer or supplier and distributor can be built. This means, in most cases, the insertion of the latter in a commercial network, which in turn means a reciprocal duty of active and loyal collaboration and a coordination of their efforts for the specific performance of the contract, as well as the reciprocal duty of information to reach identical targets.

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fundamental rights and public freedoms, as provided for in Article 11.2 of the Spanish Constitution (Chronological Legislative Catalog 1978,2836).

(41) For a concept of public interest in the European Union, a very illustrative account can be found on the *Opinions of advocate general Mr. Paolo Mengozzi*, submitted on May 30th, 2017 (1) Case C-122/16 P, following which:

"103. As I have already had the opportunity of pointing out on several occasions, (56) I endorse the approach suggested by Advocate General Jacobs in his Opinion in Salzgitter v Commission (C-210/98 P, EU:C:2000:172). (57) Thus, in my view, a plea is based on public policy where, first, the rule infringed is designed to serve a fundamental objective or fundamental value of the EU legal order and plays an important role in the attainment of that objective or the upholding of that value and, secondly, that rule was laid down in the interest of third parties or the public in general and not merely in the interest of the persons directly concerned.

104. What I am describing is therefore a requirement of legality, which could be described as an 'enhanced' requirement since it concerns the protection of 'public policy', namely the protection of the fundamental values of the EU legal order in the interest of third parties or the public in general, which justifies the power/duty of the EU judicature to raise of its own motion pleas based on public policy, even where they go beyond the pleas submitted by the parties in support of their claims."

(42) Today there can be no doubt, regarding the earlier cases of the European Court of Justice and the Full Session of the First Chamber of the Spanish Supreme Court, for example in their Judgments of 20 January 2014 (Official Case Law Catalog, Judgment of the Supreme Court 354/2014), and *265/2015, of 22 April (Collection of Law Reports 2015, 1360)* (Official Case Law Catalog, Judgment of the Supreme Court 1723/2015), that, the "economic public interest" has to be included into this undetermined legal concept called "public interest", as appears in mandatory norms and basic principles that have to be inexcusably fulfilled in cases that need special protection.

The Spanish law does not include a specific provision regarding this; so, basically, we can find contracts the duration of which is either (i) fixed, as regulated by a specific (determined or determinable) term; or (ii) open ended, either agreed upon at the beginning or consolidated by the implied extension or renewal of the contract.

It is important to point out that, by virtue of undisputed opinions, this second category includes the contracts subject to defeasance clause as a result of the uncertainty arising from the randomness of the occurrence of the condition.

Finally, we would like to point out that the lack of definition of the term is not the same as the perpetuity of the contract, as the latter implies the nullity of the contract, as article 1583 of the CC (43) expressly provides.

4. Contract termination. Special reference to minimum purchase clauses.

The duration of the agreement is also one of the relevant elements that need to be taken into account to determine the consequences of the termination and subsequent settlement of the contractual relationship. Indeed, the answers that the legal system gives in cases of termination of contract varies when the contract is open-ended or for a fixed term.

4.1. Termination by expiration of the term. Automatic termination of the contract.

The end of the term expressly agreed upon leads, in principle, to the automatic termination of the contract, and it does not require the declaration of the will of not renewing it using the corresponding previous notice. This has been discussed by some academic sectors and earlier cases, which, based on the respect towards the good faith and loyalty principles, defend the need of issuing the corresponding previous notice (44) before the termination of the agreement.

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(43) Article 1583

These kinds of services may be hired without a fixed term, for a certain time, or for a specific work. A lease entered into for life is null and void.

(44) See the Judgment of the Supreme Court of 13 February 2009, 23 December 2009, and 22 July 2008, among others.

The cases of termination of the agreement by expiration of the term do not prevent its tacit renewal, despite the existence of an agreement against it, by virtue of the *facta concludentia* (tacit consent) principle. In addition to this, the will-over-form principle of the Spanish legal system (cf. articles 1261 and 1278 of the CC and article 51 of the CoC (45)) enables the existence of an agreement without having to specifically bind it, for, as we have already said, the correctly given consent is enough.

In relation with this, it is important to consider the possible extra-contractual responsibility that may fall on the party that does not match the legitimate expectations that it may have raised by certain attitudes of the supplier, which are however followed by the effective termination of the contract.

Finally, it must be said that in cases of termination due to expiration of the contractual term, the compensations for losses would be excluded (but in some cases not the compensation for costumers), as the Judgment of the Provincial Court of Madrid of 21 March 2005 (JUR 2005 111463) has pointed out.

4.2. Unilateral termination of the open-ended contract.

The Spanish legal system, as we have already pointed out, forbids agreements in perpetuity. As a result, the power to unilaterally abandon a fixed-term agreement appears as the resource that the party has to disengage from any indefinite legal relationship.

To this it has to be added that a large part of the scientific and legal doctrine gives to the distribution agreement a trusting nature, even an *intuitu personae* (46) one, and even, more recently, an *intuitu instrumentii* (47) nature. This, along with other circumstances, in cases of open-ended contracts, allows the contractual termination (through a notice of termination) based on the decision of one of the parties, and, what is more remarkable, without the need for of a just cause.

Notwithstanding the foregoing, or, in better words, as a complement to this power, precedents have been consistent in requiring the

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(45) See notes 11 and 12.

(46) See the judgment of the Supreme Court of 9 February 2004Collection of Law Reports 2004 1189.

(47) See the Judgment No. 188/2016 of the Provincial Court of Malaga (Section 5), of 15 April 2016.

unilateral termination of the contract to be exercised following in every moment the principles of good faith and loyalty (article 7 of the CC and article 57 of the CoC) (48), which in the majority of cases requires from the party requesting the termination to give previous notice to the other party, by virtue of article 1258 of the CC (49), in a timely way (50). In this respect, the doctrine and precedents have been applying, as guiding criteria in order to determine the timeliness of the previous notice, the provisions of article 25.2 of the AAA (51) to this effect.

It is important to point out that the neglect of the duty of previous notice in a timely way, in good faith, and, in some cases, in the previously agreed upon term, will cause a compensation obligation *only* when the termination of the contract has caused losses (52) to the other party, but it will not revoke the contractual termination caused by the notice issued to this effect (53).

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(48) Article 7 of the CC

1. Rights must be exercised in accordance with the requirements of good faith.

2. The law does not support abuse of rights or antisocial exercise thereof. Any act or omission which, as a result of the author's intention, its purpose or the circumstances in which it is performed manifestly exceeds the normal limits to exercise a right, with damage to a third party, shall give rise to the corresponding compensation and the adoption of judicial or administrative measures preventing persistence in such abuse.

Article 57 of the CoC

Business contracts shall be implemented and fulfilled in good faith, pursuant to the terms under which they were made and drafted, without misinterpreting them through arbitrary constructions of the correct, proper and usual sense of the words said or written, or restriction of the effects naturally arising from the way in which the parties to the contract would have explained their will and contracted their obligations.

(49) Article 1258

Contracts are perfected by mere consent, and since then bind the parties, not just to the performance of the matters expressly agreed therein, but also to all consequences which, according to their nature, are in accordance with good faith, custom and the law.

(50) See, among others, the Judgments of the Supreme Court No. 130/2011, of 15 March, and No. 480/2012, of 18 July; Judgment of the Provincial Court of Seville No. 657/2002; Judgment of the Provincial Court of Valencia No. 118/2006, of 20 March; and Judgment of the Provincial Court of Badajoz No. 60/2014, of 12 March.

(51) Article 25.2

"The term for the previous notice will be one month for every year in which the contract was in force, with a maximum of six months. If the agency agreement had been in force for a period of less than a year, the term for the previous notice will be one month"

(52) See the judgment of the Supreme Court No. 130/2011, of 15 March.

(53) See the judgment of the Supreme Court No. 1911/2017, of 19 May.

4.3. Termination of the contract by breach of contract or just cause.

The termination of the distribution contract can also happen by just cause, by reason of its breach. In this circumstance, as there is no sectorial norm applicable to the distribution agreement, the form, requirements, and reasons for the contractual termination will those established by the legal system in general terms for contract law, which are, essentially, the following ones (54):

(i) The existence of a contractual link in force;

(ii) Reciprocity in the obligations;

(iii) Severe breach by the defendant of his obligations, preventing the normal end of the contract, thus thwarting the legitimate expectations of the other party; and

(iv) The party exercising this action should not have breached his own obligations, *Judgments of the Supreme Court of 21 March 1986 (Collection of Law Reports1986, 1275), 29 February 1988 (Collection of Law Reports 1988, 1310), 28 February 1989 (Collection of Law Reports 1989, 1409),* 5 April 1990, *and 16 April 1991 (Collection of Law Reports 1991, 2696)*, among others. The breach must be true and corresponding to a main obligation arising from the contract, nor a mere violation of an ancillary obligation, *Judgment of the Supreme Court of 3 December 1992 (Collection of Law Reports 1992, 9997) and 21 March 1994 (Collection of Law Reports 1994, 2560).*

4.4. Minimum purchase clause.

Earlier cases (55) have declared the full force and effect of clauses setting minimum objectives to be met by the distributor, providing the contractual provisions do not contravene the provisions of the applicable Regulations of the European Union. As a consequence, these precedents have also excluded the compensation for clientele in favor of the distributor when the termination of the agreement by request of the supplier was justified by the failure to meet those minimum objectives. Thus, the breach of a purchase requirement or a minimum

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(54) See the judgment of the Supreme Court No. 159/2008, of 3 March. Collection of Law Reports 2008/2935.

(55) See Judgment of the Supreme Court (Civil Chamber, Section 1), *of 15 October 2008 (Collection of Law Reports 2008/7126)*, and other judgments mentioned therein.

objectives agreement can be ground of the termination of the contract, provided that, in addition to the existence of the clause, the requirements mentioned above occur.

Precedents and doctrine have addressed the breach of the minimum purchase clause as a reason for termination from the point of view of its "reasonableness", both in relation to its own elements and circumstances and in relation to the contract in which it is inserted.

The recent Judgment of the Supreme Court (Civil Chamber, Section 1) No. 697/2014, of 11 December (following the criteria of the Judgment of the Provincial Court of Madrid, Section 11, No. 27/2016, of 4 February), states the following: "*the sale objectives of 2007 were out of any reasonableness... Leaving to the grantor the establishment of these objectives, disregarding the parameters of normality that have to govern these type of contracts, would mean allowing the unilateral and unjustified termination of the contract, and, ultimately, overtly breaking the essential principle of the "necessitas" provided for in article 1256 of the Civil Code".*

The criteria of the precedents in the aforementioned decisions make it clear that the answer to this question will be extremely casuistic.

5. Termination of the agreement: compensation and/or remedy.

5.1. Lawfulness of waiving a possible compensation.

The distribution agreement and the regulations governing it enter in the field of default rules. In contrast with other "similar" contractual figures (i.e. the agency agreement), the parties of the distribution agreement can waive their rights, unless their waiver is contrary to public interest or public policy, or causes a detriment to third parties (see article 6.2 of the CC ([56])).

In consequence, the first distinctive feature to be highlighted in the compensation system at the termination of the distribution agreement is the validity of waiving the possible compensation (for clientele of for unrecovered investments) that the distributor is entitled to at the

([56]) Article 6.2

The voluntary exclusion of applicable law and the waiver of any rights acknowledged therein shall only be valid when they do not contradict the public interest or public policy or cause a detriment to third parties.

termination of the contract. In order for this waiver to be valid, it has to be stated in a clear, precise, and explicit way (57).

Judgment No. 1208/2008 of 23 December, ruled by the Supreme Court (Civil Chamber, Section 1, Collection of Law Reports 2009/164 (58)), among others, has delivered a judgment on this matter.

And, of course, if the waiver is possible, the shaping of its limits and reach by agreement of the parties will also be so.

5.2. Compensation for investments.

According with the aforesaid (see point 3 above) the duration of the contract is an essential element at the time of determining the rights and duties of the parties when the settlement of the agreement has to be decided.

The relationships with the highest degree of litigation are those where the agreement is set for an indefinite term or has acquired an open-end condition, because in the case of fixed-term agreements, doctrine and case law unanimously understand that no compensation is generated *per se* in favor of the distributor, as we have explained above in point 4.3.

As a general rule, the termination of the open-ended agreement does not result in the obligation of compensating for losses, provided the corresponding previous notice is issued and the abandonment is carried out respecting the duties of loyalty and good faith. In this sense, *judgment 1199/2003 of 16 December (Collection of Law Reports 2003, 8665)* states that *"regarding exclusive distribution agreements which are open-ended or have no fixed term, as the one raising this case, the judgment of 28 January 2002 (Collection of Law Reports 2002, 2305) says that « earlier cases in this Chamber have repeatedly admitted the unilateral abandonment, provided there is a reasonable prior notice of the termination to the other party ».*

Otherwise, the exercise of this power would be abusive or non-compliant with good faith (Judgments of 24 February [Collection of Law

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(57) See Judgments of the Supreme Court of 21 January 2009 and 20 July 2001.

(58) See also the Judgments of the Supreme Court No.130/2011 of 15 March (Civil Chamber, Section 1, Collection of Law Reports 2011/3321, part 41), No. 88/2010 of 10 March (Collection of Law Reports 2010, 2337), of 22 June 2007 (Collection of Law Reports 2007/5427), and No. 215/2010 of 12 April (Collection of Law Reports 2010/3532).

Reports 1993, 1252] and 23 July 1993 [Collection of Law Reports 1993, 6476], among others), as it constitutes a forbidden behavior under article 7 of the CC" ([59]).

Now, we have described the power of abandonment, which is not the same as the possible compensation that can be generated for unrecovered investments at the time of the termination that we will analyze below.

First, it has to be said that in case of a compensation being generated, it can be articulated either by analogical application of article 29 of the AAA ([60]) (if the necessary conditions occur, that is, provided there is *ratio* ([61])), or by including the breach within the concept of recoverable damage generally contemplated for contract law in articles 1101 and 1106 of the CC ([62]).

Anyway, precedents have been considering the following requirements as needed for its consideration:

(i) The compensation for investments has *a remunerative nature, not merely compensatory*. That is why it is compatible with a possible compensation for losses caused by insufficient notice of termination, this one being eminently compensatory.

(ii) *It must be an open-ended agreement*. Without prejudice to this, the compensation for unrecovered investments in fixed-term agreements will also apply if the termination occurs due to a breach of the supplier. In such a case, the compensation will be part of the losses that can be compensated under articles 1101 ([63]) and 1106 of the CC.

Compensation will be applicable even in cases when the previous

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([59]) See note 48.

([60]) Article 29. Compensation for losses

Notwithstanding the compensation for customers, the owner that unilaterally terminates the open-ended agency agreement is bound to compensate for the damages that the premature termination has caused to the agent, provided that doing so prevents the recovery of the expenses that the agent, guided by the owner, has made to execute the contract.

([61]) See the Judgment of the Supreme Court of 23 January 2007.

([62]) Article 1106. Contents of the compensation for losses

Damage compensation comprises not just the value of the loss suffered, but also that of the gain which the creditor has failed to obtain, save for the provisions of the following articles.

([63]) Article 1101. Damages of the obligations

Persons who, in the performance of their obligations, should incur in willful misconduct, negligence or default, and those who in any way should contravene the content of the obligation shall be subject to compensation of any damages caused.

notice is given in a timely way, but with not enough time to allow the recovery of the investments carried out to fulfill the agreement.

(iii) *The termination must occur by unilateral decision*. No compensation will apply when the repudiation (or better, the termination) happens because of breach of the distributor of the undertaken obligations (the payment or the non-competition agreement, among others). However, the compensation will apply if the supplier's breach occurs before, the reason for this being the reciprocal nature of the contract and the provision of article 1124 of the CC (64).

(iv) *There are unrecovered investments*. These investments are defined as the expenses that are precise and necessary for the fulfillment of the agreement, which are normally indicated by the supplier. Thus, this concept does not include superfluous expenses or expenses which are out of proportion with the generated activity.

(v) *Lack of recovery of the investment*. The lack of recovery must be considered at the time of termination of the contract (65).

(vi) *Burden of proof*. The burden of proof lies with the distributor, who has to demonstrate the occurrence of the requirements for this kind of compensation (66).

5.3. Compensation for clientele.

i) The compensation for clientele in the field of the commercial distribution agreement arises some important issues that have attracted the interest of case law and doctrine.

The first of them is related with the legal justification that allows the generation of the compensation for clientele. The second, in case the compensation is due, concerns the parameters that have to be taken into account to calculate the amount of this concept.

Both questions have been tackled by the precedents of the Supreme Court, which, after some oscillation, seems to have finally settled in recent Judgment No. 1911/2017 of 19 May 2017 - ECLI: ES:TS:2017:1911, despite the opinions against the analogical application of the AAA, even as an inspiring norm, as we have explained above.

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(64) Article 1124. Power to terminate obligations

The power to terminate obligations is deemed to be implied in reciprocal obligations, where one of the obligors should not perform his obligation

(65) Judgment of the Supreme Court of 23 April 2005.

(66) Judgment of the Supreme Court of 11 December 2007.

Given the *ratio decidendi* of the aforementioned Judgment (and other judgments mentioned in the corresponding legal grounds for decision), we can state that the position of the Supreme Court is now consolidated into the opinion that the analogical application of the norms of the AAA (article 28 (67)) on the compensation for clientele in cases of termination of exclusive distribution agreements cannot be made automatically; instead, the circumstances surrounding the case under consideration must be always studied (68).

ii) However, this judicial position has not been the only one in which the Supreme Court has decided on the appropriateness of the compensation for clientele. Indeed, before and after the entry into force of the AAA, we find a body of precedents that based the granting of the compensation for clientele on the figure of unjust enrichment (69), by way of the analogous application (*iuris*) of the remunerative argument (70), and, in some cases, although isolated, in the need to

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(67) Article 28. Compensation for customers

1. Upon termination of the agency agreement, whether the term is fixed or open-ended, the agent who has brought new customers to the owner, or has noticeably increased the operations with the existing customers, will be entitled to a compensation if his previous activity can continue producing substantial advantages to the owner, and if it is fairly appropriate due to the existence of non-compete agreements, lost commissions or other occurring circumstances.

2. The right of compensation for damages also exists in case the agreement is terminated by death or declaration of death of the agent.

3. The compensation will in no case exceed the average annual amount of the remunerations received by the agent during the last five years, or during all the term of the contract, if it was less than that.

(68) Judgment of the Supreme Court No. 1911/2017 of 19 May 2017 - ECLI ES:TS:2017:1911. Second Legal Ground, point 4.

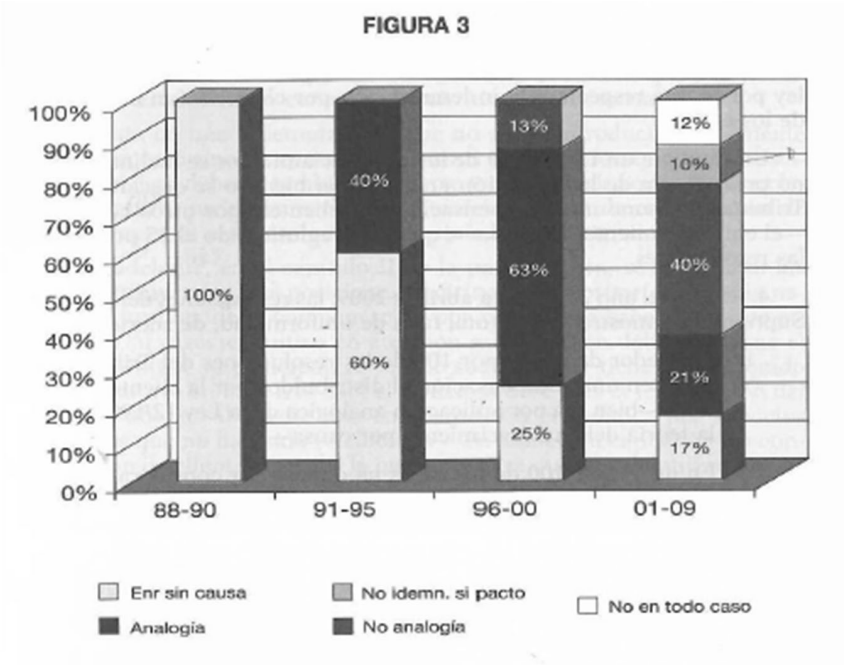
"The reason must be dismissed. Regarding the open-ended distribution contract, where the unilateral termination of the contract is made without previous notice, this Chamber, in its Judgment No. 569/2013 of 8 October, has declared what follows: « [...] The precedents on the inadmissibility of a mimetic or automatic application of the legal framework of the agency agreement to the distribution agreement reaches not only the compensation for customers, but also other legal provisions, such as the obligation of giving previous notice in case of termination of an open-ended agreement » (Judgment No. 378/2010, of 22 June, citing previous judgment No. 239/2010, of 30 April)".

(69) See, for all, the Judgment of the Supreme Court of 5 May 2006. A study of the precedents can be seen in Judgment of the Court of 15 January 2008.

(70) The Supreme Court, in its Judgment of 18 March 2004, seems to contradict this argument, as it considers that not only the provision of customers is inherent to the fulfillment of the contract (by virtue of article 1258 of the CC), but it is also its natural consequence.

protect the distributor, as it can be considered the structurally weakest party of the contract, thus deserving a protected position (71).

In order to clarify this, the following statistic made by Foncutberta Llanes, Javier (72) and reflected in the following chart can be very illustrative:



1. As it can be seen, between 1988 and 1990, the decisions grant the compensation based on the unjustified enrichment theory.

2. However, between 1991 and 1995, the compensation for clien-

(71) To conclude, we will point out that today we seem to have gotten over the traditional assumption that the distributor is the weakest part of the distribution chain. Today, this premature point of view does not meet the reality, and that is the reason why the Commission Regulation 330/2010 of 20 April 2010, on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices, when fixing the 30% of the market share that can be reached as a consequence of an agreement, considers not only the market share of the supplier, but also the market share of the distributor.

(72) See Foncutberta Llanes, Javier, *El contrato de distribución de bienes de consumo y la llamada indemnización por clientela*, Marcial Pons, Esade, 2009, pages 31 et seq.

tele is based in a 60% of the cases in the unjustified enrichment (*iuris* analogy), while the remaining 40% is based on the application of the Agency Agreement Law. Please note that the AAA was issued in 1994.

3. In the period between 1996 and 2000, the Supreme Court decided to grant the compensation based on the AAA in the 63% of the cases.

4. From 2001 to April 2009, the Supreme Court shows the lack of homogeneity in its decisions.

iii) Anyway, we understand that today the judicial position most widely accepted is the one appearing in the aforementioned and very recent judgment No. 1911/2017 of 19 May 2017 - ECLI: ES:TS:2017:1911. This is the reason why we will focus our analysis in the analogical application (*analogia legis*) of the AAA, requiring the examination of the requisites that have to occur for the compensation for clientele to be granted, which are basically the following ones (73):

1) *The termination of the contract*. In this situation, the compensation applies both in fixed-term contracts and open-ended contracts (74). However, the termination should not be attributable to the distributor.

2) *The provision of new customers or the remarkable increase in the existing ones, and the fact that the activity developed can keep bringing benfits to the owner, either directly or indirectly* (75). It is enough with the advantage being potential (76), not producing compensation when the existing customers have only been maintained (77).

3) *The compensation must be fair according to the occurring circumstances*. The reasons considered to determine the compensation are, among others, the existence of non-competition agreements (78), the brand image (79), the particularities of certain sectors (vehicles) (80), and the advertising activity executed by the distributor (81).

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(73) For a detailed study of the requirements the occurrence of which is required by article 28 of the AAA, we refer to VV.AA., *Termination of agency contract: termination indemnity*, published by CRINT (Commissione Rapporti Internazionali) of the Official Bar Association of Milan (Ordine degli Avvocati di Milano).

(74) Judgment of the Supreme Court of 3 March 2011.

(75) Judgment of the Supreme Court of 12 July 2010.

(76) Among others, Judgment of the Supreme Court of 06 November 2012

(77) Judgment of the Supreme Court of 28 January 2002.

(78) Judgment of the Supreme Court of 29 October 2006.

(79) Judgment of the Supreme Court of 3 March 2008.

(80) Judgment of the Supreme Court of 21 January 2009 and 22 July 2008.

(81) Judgment of the Supreme Court of 01 June 2009.

5.4. Calculation of the compensation.

The second relevant aspect to consider upon determination of the application of the AAA norms to the situation, or, if applicable, the appropriateness of the compensation for clientele, is decisive whether the amount of the compensation must be calculated on the "gross" or "net" margins of the "remuneration" received by the distributor.

As the Spanish Legal System does not have an autonomous regulation governing the distribution agreement, we should consider how to define the concept of "remuneration", and which concepts should be included therein, as it is the term used by article 28 of the AAA to establish the calculation base to set the compensation for clientele. This question, which may seem merely semantic, entails a difficult interpretation with evident practical consequences. Indeed, the distributor, as such, does not receive"remuneration", for what he receives of generates form his activity comes, basically, from the difference between the purchase and sale prices of the product in question, i.e. the "gross margin".

The Supreme Court, in its Judgment of 19 March 2017 (see Legal Ground 4, point 2), finally concludes that in the situations in which the norms regulating the compensation for clientele are applicable to exclusive distribution agreements, the calculation base would be the "net" remuneration received by the agent, or in this case, the distributor.

The mentioned ruling seems to hear the opinion of an important sector of the doctrine (82), and seems to settle, at least momentarily, the controversy arisen around this important matter.

We would like to go further and point out that the ruling that we have mentioned introduces also an important nuance to the form and reach of the analogical application of the AAA to exclusive distribution cases. It is important to highlight that, although the Judgment applies or gets its inspiration from article 28 of the AAA, at the same time seems to set an autonomous concept, different from the concept for the agency agreement, of what should be understood as "remuneration" in distribution agreements, given that the Supreme Court itself, in Judg-

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(82) M. A. Domínguez, in Al. Caravaca and others, *Contratos internacionales*, page 1230, who undestand the term "remuneration" in a restrictive sense. See Fernando Martínez Sanz y otros, in *Comentario a la Ley sobre contrato de agencia*, Civitas, 2000, pages 486 et seq.

ments No. 206/2015 of 3 June and No. 404/2015 of 9 July declared, in agency cases, that the remuneration considered to fix the compensatory amount is, precisely, the gross remuneration (83).

Certainly, the solution reached by the Supreme Court in its Judgment of 19 May 2017, mentioned above, can solve situations in

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(83) In cases of agency agreements, the Supreme Court understands that the term "remuneration" used in article 28 of the AAA should be understood broadly, thus getting closer to the term of "gross" remuneration, basing that decision in the remunerative nature of the compensation for customers. This way we can get over the classical academic discussions arisen due to the consideration by precedents and scholars of the compensatory nature of the compensation for customers based on the unjust enrichment.

In this sense, the Supreme Court bases its ruling on the following grounds:

1. The *purpose* of article 28, following the particular and dynamic nature of the agency agreement, has, basically, a *remunerative function*, legally provided upon termination of the contractual relationship.

2. The *remunerative value* appears, in a determinable way, on the benefits or *advantages that, as a consequence of the activity carried out by the agent, remain, upon termination*, in favor of the owner.

3. It should be taken into account that article 28 of the AAA has its origin in article 17.2 of Directive 1966/653/CEE SIC, of 18 December (LCEur 1986, 4697). In this sense, the European Union Court of Justice, in its *judgment of 26 March 2009 (EUCJ 2009, 71)*, TurgaySenen against DeustcheTanoilOmbh, determined the procedure established by article 17, describing three consecutive phases for its application:

First, the *calculation of the advantages or benefits resulting in favor of the owner* (article 17(2) a).

Second, the verification of whether the amount obtained based on the criteria of the previous calculation is fair, taking all the circumstances of the case into account.

Third, and last, comparing the amount of the resulting compensation regarding the minimum or maximum amounts established in the norm (article 17(2)b of the Directive and 28.3 of the AAA).

Determining the maximum amount of the compensation for customers (28.3 AAA) responds to the legal framework that the norm establishes for the *concept and compensatory system for the agent resulting from articles 11 to 18 of the AAA*. Thus, the remuneration is considered a remuneration for the activity carried out by the agent, that is, the promotion and/or performance of acts or operations entrusted to him (articles 1 and 3 of the Directive and articles 1, 5, and 9 of the AAA).

Based on the previous premises, the concept of remuneration *cannot consist of the net benefit* obtained by the agent while exercising his activity, *but of the quantity that he really received in exchange for his activities*. Likewise, by virtue of article 18 of the AAA, in principle, the remuneration *does not include either the refund of the expenses* payed by the agent for carrying out his activity as an independent professional.

Therefore, the Court concludes that the amount of the *compensation for customers cannot take into account the net benefit of the agent, but the remuneration considered as a whole*.

which the "gross remunerations" which are subject to the complaints are excessively high (84), and, thus, unrealistic.

5.5. Compatibility between the compensation for losses and for clientele.

We would like to finish this section devoted to the termination and settlement of the contract by briefly pointing out that the compatibility between the compensation for losses and the compensation for clientele has been expressly admitted by the precedents of the Supreme Court (Civil Chamber, Section 1), for instance, among others, Judgment No. 130/2011 of 15 March (Collection of Law Reports 2011/3321, point 43). This compatibility is based, in essence, on the different legal nature traditionally attributed to each of them. In this sense, the compensation for clientele tries to compensate an unjust enrichment, thus having a strong compensatory nature, while the compensation for losses has an eminently compensatory nature.

6. Stock of the product after the termination of the agreement: Rights and duties of the parties.

The clearance of the remaining stock upon termination of the distribution agreement is another matter that has provoked a big number of controversies. Also in this aspect, the duration of the contract appears again as a decisive element, given that the answer given by the legal system to this matter differs depending whether the agreement is open-ended or for a fixed term.

Thus, in the absence of an explicit agreement (85), at the end of the fixed-term contract the distributor has to take over the unsold stock. The doctrine understands that this circumstance is part of the risk assumed by the distributor during the time the contract is in force. This conclusion, however, is not absolute, and it can be modified if there are post-contractual non-competition agreements that prevent the future commercialization of the products. We believe, also, that the conces-

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(84) The Judgment of the Supreme Court of 16 October 1995 determines the amount of the compensation for customers as "the amount resulting from the value of the revenues that would be obtained by the distributors on average in a year".

(85) In case there is a contractual provision regarding this respect, it must be scrupulously observed. See Judgment of the Supreme Court of 03 March 2008.

sion by the supplier of an exclusive distribution right in favor of third parties could be an element to be taken into account to redefine the strictness of the application of the aforementioned risk theory.

Regarding open-ended contracts, and also in the absence of an explicit contractual provision, case law and doctrine consider that the term for the previous notice to be sent by the supplier to the distributor shall be enough and respectful with the good faith and loyalty requirements, being the previous notice a kind of ideal mechanism for the distributor to manage the stock of the product appropriately (86).

In parallel to these considerations, certain sectors among legal doctrine (87) refer to the provisions of article 1258 of the CC (88) to support the possible obligation of repurchase of the remaining stock. As it has been said, the distribution agreement is characterized by its stability in time, the integration of the distributor in a commercial network, etc., which may require him to keep a certain amount of the product in stock in order to be promptly able to fulfil the agreement. From this point of view, keeping a stock for this purpose can be similar to an obligation expressly agreed upon between the parties of keeping a minimum quantity of the product, in order to be able to effectively fulfill the agreement. If this is the case, it can be argued that the termination of the agreement should also include the repurchase of the stock.

In any way, we understand that the repurchase of the stock must be done at the original purchase price and not the sale price, and, obviously, the product must be returned in order to avoid an unjust enrichment (89), in this case an unjust enrichment of the distributor.

Finally, we can point out that, when the agreement is terminated by

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(86) There is a Judgment of the Supreme Court (21 December 2005) that rules against this, as it declares that there is no obligation of repurchase, although it acknowledges that the sale of the products in stock will be made in less favorable conditions.

(87) See Mª José Varquero Pinto, *Los contratos de distribución comercial*, in Carbajo Cascón, Fernando (Director), *Las propuestas armonizadoras del derecho contractual europeo*, Tirant lo Blanc, 2015, pages 565 et seq.

(88) Article 1258 [Perfection of the contracts]

"Contracts are perfected by mere consent, and since then bind the parties, not just to the performance of the matters expressly agreed therein, but also to all consequences which, according to their nature, are in accordance with good faith, custom and the law."

(89) See the Judgment of the Supreme Court of 2 December 2005, among others.

breach of contract of the distributor, he has to accept all the unfavorable consequences resulting from this termination (90), and thus he has to take over the whole remaining stock. On the contrary, when it is the manufacturer the one breaching the agreement, or in case the termination of the contract occurs with abuse, disloyalty or bad faith, the repurchase of the stock will be part of the losses compensated to the distributor (article 1106 of the CC (91)).

II.
THE FRANCHISE AGREEMENT

1. Preliminary Considerations.

1.1. Regulatory Framework.

The Spanish legal system does not contain provisions thoroughly and specifically ruling the franchise activity.

The first legal reference to the franchise agreement is the definition provided in this respect by the Act 7/1996, of 5 January, on Retail Commerce. Such regulatory framework is not enough to regulate the franchise as it has just one article, which gives an idea of the scarcity of the mentioned Act. In fact, such article, namely number 62 (92) of the mentioned Act 7/1996, merely offers a descriptive definition of the commercial activity in franchise regime indicating that "*is that executed by virtue of an agreement or a contract by which a company, named franchiser, gives another, named franchisee, the right to exploit a proprietary commercialization system of products and services*".

Albeit this Act was intended to regulate new contractual figures in the commercial sector, the Spanish legislator failed to regulate and

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(90) See Judgment of the Supreme Court of 1 February 2001.

(91) See note 62.

(92) Act 7/1996, of 15 January, on Retail Commerce, in the wording given by Act 1/2010, of 1 March, includes the regulation of franchise agreements in its article 62 defined below: "*the commercial activity under franchise agreements is implemented by virtue of an agreement or contract for which a company named franchiser, transfers to another, named franchisee, the right to exploit the former's own commercialization system of products or services*".

legally develop the franchise relationship at state level, since it is clear that the provision which we are transcribing is utterly insufficient to regulate the legal relation contained in the concept of commercial franchise.

This legal vacuum was pervaded with the transposition of Directives to the Spanish legal system and the application of European regulations until the publication of the Royal Decree 201/2010, *by which the commercial activity under franchise agreements and the communication of data to the franchisers registry is regulated* (93).

The aforementioned Royal Decree, pursuant to the Act 7/1996 on Retail Commerce, so as to transpose the Community Directive 2006/123/EC (service directive) to the Spanish regulations and develop the currently derogated Regulation (EC) 2790/1999 of the European Commission, of 22 December, has as objectives (i) the establishment of the basic required conditions to develop the activity of franchise transferal

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(93) Article 2 Commercial activity under franchise agreements, states that

1. For the purposes of this Royal Decree, a commercial activity under franchise agreement, regulated by article 62 of the Act 7/1996, of 15 January, on Retail Commerce, is understood as such activity conducted by virtue of the contract by which a company, the franchiser, transfers to another, the franchisee, in a specific market and in return of a direct and/or indirect financial compensation, the right to exploit the franchise of a business or a commercial activity that the former has previously developed with sufficient expertise and success, to commercialize different types of products or services which include, at least:

a) The use of a common name or label, or other intellectual or industrial property rights, as well as a uniform layout of the establishments or transportation means under the agreement.

b) The notification to the franchisee by the franchiser of technical knowledge and a know-how, which shall have to be his/her own, substantial and singular.

c) The continuous provision of a commercial and/or technical assistance to the franchisee by the franchiser during the validity of the agreement; all this without prejudice of the supervisory powers that may be contractually established.

3. The exclusive commercial or distribution granting, for which a businessperson undertakes the acquisition of certain conditions, products — which generally belong to a brand —, to other party which grants certain exclusivity within an area to re-sell them as well under certain conditions, and the provision of assistance to the buyers of these products once the purchase has been made, will not necessarily be considered a franchise

4. The following legal relations will not be considered a franchise either: (a) The granting of a manufacturing license, (b) the transfer of a registered brand for use in a certain area, (c) the transfer of technology, (d) the transfer of the use of an ensign or a commercial label.

and (ii) the regulation of the functioning and organization of the registry of franchisers (94).

With the entry into force of such Royal Decree, the franchise contract ceases to be, for the Spanish legal system, a quasi-innominate contract to become a commercial system with legal support, since (i) a new definition is offered for the legal activity in the franchise regime, (ii) the registry of franchisers is created and (iii) minimum pre-contractual conditions are fixed for the first time.

Likewise, we shall highlight that Spain joined the European Franchise Federation (EFF) in January 2015 and, therefore, the European Code of Ethics (95) published in 1972 in light of the need to regulate the franchise agreement and through which it was intended to create a "Code of Ethics" and thus define and self-regulate the franchising legal regime (96).

Said Code inspired and established the essential and unique concepts of the institution such as the know-how, the identity, and the brand image while simultaneously determining the general principles that shall govern all legal relation of the franchise.

It should also be noted that, at national level, the Spanish Association of Franchisers was created.

Each of these factors, among others, have resulted in the Code being a mandatory regulation for the parties who agree to it, as well as a reference standard which different legal resolutions have used as a

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(94) Refer to Judgment of the Supreme Court, of 21 October 2005 (RJ 2005/8274), which contains all regulatory and case-law treatment regarding the franchise contract: "*[...] RD 1.750/1987, of 18 December (RCL 1988, 56, 135), on the liberalization of the technological transfer and the provision of foreign technical assistance to Spanish companies (repealed by theRD 1.816/1991, of 20 December[RCL 1991, 3013]);RD 157/1992, of 21 February(RCL 1992, 487), for which the Antitrust Law is developed;Law 7/1996, of 15 January(RCL 1996, 148), on Retail Commerce, which is confined to the distribution and service modalities, notincluding the industrial, and defines the retail commercial activity under article 62; and RD 2.485/1998, of 13 December(RCL 1998, 2769), which develops article 62 of the Law;stating that such commercial activity is executedthrough the franchise agreement; subject toEuropean Law (Regulation 4.087/88 [LCEur 1988, 1748], currently included in* Regulation*); and creates the Registry of franchisers [...]*".

(95) "The European Code of Ethics of Franchising" was passed by the European Franchise Federation on 22 September 1972.

(96) Martínez, Picazo, G. and Pardo de Andrade, J. G., *Capítulo 1: Normativa y Deontología. Marco Legal español. Aplicación e interpretación jurisprudencial.* P344, in Ortega Burgos, E., *La Franquicia,* Edición Aranzadi, 2015.

complementary policy document to settle the controversies resulting from the relations cited under the "franchise" concept.

1.2. Concept. Characters of the franchise contract.

1.2.1. Concept.

The regulatory framework of the franchise regime is formed, on the one hand, by the European Code of Ethics and, on the other, by the case laws which, since the 90s' has given content to the franchise and that has developed the guiding principles forming the typical terms and conditions of the agreement.

Regarding the legal nature of the agreement, the doctrine is merely unanimous on the fact considering that the contract is based on the freedom of the parties to create a mandatory relation with no further limits than the law, the moral and the public order, as set forth in article 1255 [97] of the Spanish Civil Code. Henceforth, the divergences on the remaining aspects which characterize the institution are extensive.

The first precedent to the franchise contract can be found in the Spanish Supreme Court Ruling of 15 May 1985 (RJ 1985, 2393), which defines "*franchising*" as "*(...) the authorization granted by the franchiser to the franchisee to use the brand, normally international, by integrating it to its commercialization network [...]*".

Nonetheless, the definition and scope of the franchise contract was analyzed in detail initially in the Judgment of the Supreme Court of 27 September 1996, (RJ 1996, 6646),which takes the Judgment of the Court of Justice of the European Communities, of 28 January 1986 (CJEC 1986, 34) of the "Pronuptia" case [98] as a reference, and on the basis of which it declares that "*from a dogmatic point of view, it has been defined as a contract signed between two legal and economical independent parties, by virtue of which one, (franchiser) grants the other (franchisee) the right to use under specific control conditions and for a limited period of time and in a limited area, a technique in the industrial,*

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[97] Article 1255 of the Civil Code

"*The contracting parties may establish any covenants, clauses and conditions deemed convenient, provided that they are not contrary to the laws, to morals or to public policy*".

[98] Supreme Court Ruling of the European Court of Justice of 28 January 1986, Official Journal No.L013, of 15 January 1985 p.0039-0047.

commercial, or service provision activity of the franchisee, being the latter obliged to pay the former an economic compensation".

Likewise, the 1st Division of the Supreme Court, in the Ruling of 4 March 1997 (RJ 1997, 1642) underlines once again that: "*the main characteristic of this contractual modality consists in one of the parties, who is the owner of a certain brand, label, emblem, formula, method or manufacturing technique, or commercial or industrial activity, granting the right to use, for a specific period and in a specific geographical area, under certain control conditions, the item that he/she holds ownership of, in return of an economic compensation, which is generally established by setting a fee or a percentage*".

The fact that the franchise agreement is an atypical contract, determines that it is governed, first of all by the will of the parties reflected in the clauses that they may freely agree upon and only, in a subsidiary way, in the case of content gaps, it shall be necessary to refer to typical contract figures related to this consensual and atypical contractual relation" (99). In the absence of specific regulation — apart from the aforementioned —, the main principle of obligations is the franchise contract itself.

Summarizing the mentioned case-law doctrine, we can define the franchise agreement as that agreement by which the businessman who owns the franchise (franchiser) grants to another businessman (franchisee) the use of technical knowledge and intangible elements for the manufacturing of a product or the homogeneous commercialization of a product or service in return for the payment of an entrance fee and a maintenance fee normally established depending on the sales figure (100) (101). In this sense, the former is obliged to transmit to the

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(99) See Provincial Court of Barcelona Ruling (14th Section) of 10 June 2004 (AC 2004/1100).

(100) Alonso Soto, R., *Los contratos de distribución comercial*, in Uría, R. y Menéndez, A., *Curso de Derecho Mercantil*, Volume II, 2nd Edic., Thomson-Civitas, Madrid, 2007, page 203. The professor Garrigues, J. also declares so in *Curso de Derecho Mercantil*, volume II, 7th Edic., Madrid, 1980, page 128: *"a special modality of transfer happens with the agreement intended for the transferee to use the distinctive signs of the transferor and, under specific instructions of the latter, for the former to cooperate with the development and sale of products, or the provision of certain services. The transferee shall bear the costs of the organization of the business, taking his/her own risks, despite the control exercised by the transferor*".

(101) In this sense, three types of royalties shall be distinguished in the franchise: the *entry royalty*, which is defined as the non-refundable amount that the franchisee

latter (i) the right to use the brand, labels, and distinctive signs, (ii) the exclusivity of the franchise or business model for the agreed area, (iii) the technical and commercial know-how, and (iv) the training of the staff and permanent technical assistance of the franchiser. More specifically, we can stress that the franchise is a system of commercialization of products articulated through a business technique by which the franchiser centralizes the intangible capital of the franchise network (know-how, distinctive signs, patents, copyright, product design, business policy direction, sales techniques, advertising, marketing, etc.) by decentralizing, among others, the work factor and granting the franchisees the right to exploit the business idea in accordance with the concept and criteria of the franchiser (102).

1.2.2. Characteristics.

The franchise agreement is mainly characterized by the following distinctive characteristics:

(i) Bilateral agreement: its refinement is carried out between two defined parties, and its formalization leads to mutual rights and obligations;

(ii) *Intuitu personae;*

(iii) Commercial agreement: the scope of the agreement is commercial, as well as the participating subjects (103);

(iv) Onerous agreement: the parties perform a service with mutual patrimonial content;

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pays to be part of the franchise chain, whose economic contribution is justified by the advantage of being able to use distinctive signs, which are well-known in the market, the know-how, and partially compensating the franchiser for the conducted investments (e.g. franchise manuals), the comprehensive assistance and the provision of training to the franchisee throughout the validity of the agreement; the *maintenance fee* is the amount that the franchisee shall periodically pay, either in a fixed or in a variable way, which may be coordinated either through a percentage of sales (direct) or of the articles provided by the franchiser (indirect), or through a previously stipulated amount; and the *advertising fee*, which is built with common funds for the investment by the franchiser in advertising and marketing campaigns, which are articulated for the benefit of all the franchise chain and which helps with the consolidation of the commercial brand.

(102) Lázaro Sánchez, E.J., *El contrato de Franquicia (aspectos básicos), Anales de Derecho*, number 18, Universidad de Murcia, 2000, page 92.

(103) See Provincial Court of Barcelona Ruling, 15th Section, of 24 July 2013, which establishes the Regulation for the Defense of Consumers and Users is not applicable to the franchisees.

(v) Atypical agreement: it lacks a specific legal regulation to regulate the contract of the franchise agreement itself (104);

(vi) Mixed agreement;

(vii) Adhesion agreement (105).

1.3. Requirements and validity of the agreement.

1.3.1. Registration in the Franchisers Registry.

So as to include the Community Directive 2006/123/EC of the European Parliament and of the European Council, of 12 December, on the services of the domestic market, by means of the Royal Decree 201/2010, of 26 February, which develops the obligation imposed on the franchiser companies who wish to conduct their activity in Spain, to communicate the commencement of their activity to the national Public Registry of franchisers within three months of activity commencement (106).

In this sense, the case law is unanimous when considering the

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(104) As reminded by the 1st Division of the Supreme Court Ruling No. 145/2009 of 9 March (RJ 2009, 1129): "*the franchise is a nominated agreement as it is envisaged in the regulation, but it continues to be atypical in that it does not benefit from legal regulation, which has led to, just as in France, for the Spanish Association of Franchisers to adopt a Code of Ethics, which does not have mandatory effects*".

(105) It is a contentious issue at case-law level, even if the main thesis is that, despite the franchise agreement being normally considered as an adhesion agreement, article 8 of the Law of General Hiring Conditions is not applicable, as it is applicable to consumers and users, and the franchisee is neither.

(106) Article 62.2 of the Act 7/1996, of 15 January, on Retail Commerce: Regulation of franchise agreements

"2. *The natural or legal persons who intend to develop, in the Spanish territory, the activity of franchiser set forth in the previous section, shall notify the commencement of its activity within three months from initiation to the Registry of Franchisers, which shall include the data established under the regulation.*

The companies of third countries, not established in Spain, whose intention is to develop the franchiser activity in Spain, shall notify it directly to the Registry of Franchisers of the Ministry of Industry, Tourism and Commerce, within three months from initiation of the activity.

The Ministry of Industry, Tourism and Commerce shall notify the Autonomous Communities of the registered franchiser companies.

Likewise, the Autonomous Communities shall notify the Registry of Franchisers of the Ministry of Industry, Tourism and Commerce of the modifications made in the corresponding autonomic registry".

communication system establishing the standard merely comprises an administrative communication system — without minor consequences in case of breach —, but it does not constitute a validity and efficiency requirement of the agreement (107).

Essentially, the central Registry has, according to article 6 of the mentioned Royal Decree, the following functions:

(i) Registration of the franchisers in the registryon proposal of the Communities;

(ii) The assignment of an individualized key of registry identification;

(iii) Periodical update of the list of franchisers registered in the registry and the franchised premises;

(iv) Registration of cancellations of franchisers;

(v) Issuance of the appropriate supporting certifications of the franchisers registered in the registry and of the key correspondence of registry identification;

(vi) The granting of access to the registry information to the administrative bodies of the Autonomous Communities who request so, in accordance with the provisions set forth in article 10 in coordination with the autonomic registries;

(vii) The provision of public information to the citizens, requested on the registered franchisers;

(viii) Registration of franchisers who do not have their premises in Spain or in the European Union, who shall provide their data directly to the Registry, as well as the posterior modifications of the data;

(ix) Any other functions consistent with their activity.

In turn, article 7 of said Royal Decree establishes the procedure to carry out the communication of data, which shall take place along with the communication of data or the commencement of activity, through its appearance either before the competent body of the Autonomous Community or directly before the franchisers of the Ministry of Industry.

Such communication includes, but it is not limited to:

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(107) The case law is unanimous in this sense, stating that the obligation to register the agreement in the registry of franchisers only has administrative effects, and not registration it does not affect the validity and the nullity of the agreement. See Provincial Court of Madrid Ruling (11th Section), No. 83/2010, of 30 December (AC 2010, 747), and the Provincial Court of Madrid (14th Section) No. 270/2010, of 5 May (AC 2010, 1029), which support the same criterion.

(i) Franchiser data, such as name or business name of the franchiser, his/her address, the inscription data in the Business Registry, where appropriate, and the number or code of tax identification;

(ii) Designation of industrial or intellectual property rights under the franchise agreement and accreditation of having the ownership and the right to use the license granted and in force, as well as their validity and eventual judicial remedies brought before by the owner or user of the brand, where appropriate;

(iii) Description of the franchised business, including number of franchisees of the network and the number of establishments integrating it, creating a difference between those exploited directly by the franchiser and those operating under franchise agreements, indicating the municipality and province where they are located. It shall also be indicated the time that the company has been carrying out the franchising activity, specifying the private and franchised establishments, as well as the franchisees who have ceased to be part of the Spanish network in the past two years;

(iv) In the event the franchiser is a master franchisee, he/she shall include the information related to the following data of his/her franchiser: name, business name, address, legal structure and duration of the master franchise agreement, and prove the existence of an agreement accrediting the cession by the original franchiser;

(v) The companies registered by means of proxy shall demonstrate that they have the document accrediting this condition.

Complementarily, the franchiser may notify the registry, voluntarily and for advertising purposes, the following documentation:

(i) The possession of an quality certification regarding compliance of quality standards;

(ii) The adhesion to an extra-judicial conflict solving system;

(iii) The signature of codes of practice in the franchise context;

(iv) The adhesion to an arbitration system or other extra-judicial conflict solving systems.

Ultimately, we shall also indicate that the registered franchisers are obliged, regarding the notification of data they may have performed, to:

(i) Notify the franchisers registry any change of data whose notification is mandatory within three months from when such change occurs, and the cessation of the franchising activity whenever it takes place;

(ii) On an annual basis, during the month of January of each year,

closures or openings of own or franchised stores produced in the previous annuity;

(iii) In the event of lack of data communication, following warnings, the franchiser companies will be automatically deregistered, establishing the impossibility to continue with the activity.

Given the political and administrative decentralization that governs in Spain — Autonomous Communities — the corresponding departments of each of the Autonomous Communities are the bodies responsible for creating and managing the Registries in which the franchiser company is registered. Such registries are, likewise, obliged to notify the data of the inscriptions and the changes, if any, to the Central Registry of Franchisers of the Ministry of Industry, Tourism and Commerce.

This system of notifications intends to help the franchisee verify the antiquity, the reputation and the image of the franchiser.

It is essential to note that non-compliance to the regulations by a Spanish or foreign company carrying out franchiser activity in Spain and failure to notify the commencement of activity to the Registry of Franchisers within the legal term, may result in a fine of between €6,000 and €30,000 as set forth in article 68 of the Act 7/1996, of 15 January ([108]).

([108]) Article 65.1 of the Act 7/1996, of 15 January, on Retail Commerce: Amount of the penalties

r) Non-compliance with the initial obligation to notify the Registry of Franchisers by those who grant the franchise agreement within the period set forth under article 62.2, as well as the fail to carry out the annual update of data. Letter r) under number 1 of article 65 worded by section ten of the single article of the Law 1/2010, of 1 March, which amends the Law 7/1996, of 15 January, on Retail Commerce. (Official Gazette -BOE- of 2 March). Validity: 3 March, 2010

s) Delivering misleading or clearly insufficient information, when it has been requested in accordance with the applicable regulation and that has essential nature, and thus triggering severe damage or where it is motivated. Letter s) under number 1 of article 65 introduced by section ten of the single article of the Law 1/2010, of 1 March, which amends the Law 7/1996, of 15 January, on Retail Commerce (Official Gazette -BOE- of2 March). Validity: 3 March, 2010

Article 68 of the Act 7/1996, of 15 January, on Retail Commerce: Amount of the penalties

"2. The severe infractions shall be punished with a fine from €6,000 to €30,000".

1.3.2. Pre-contractual information.

The standard under consideration likewise obliges the franchiser to send to the franchisee, in writing and at least 20 working days before the formalization of the agreement, the necessary information on the franchise, franchiser data, description of the activity sector of the business, content and characteristics of the franchise and of its exploitation, structure and extension of the network, as well as other essential elements of the franchise agreement (109).

In regard with this obligation, article 3 of the Royal Decree 201/2010 develops in great detail the scope of information the franchiser shall provide to the future franchisee (110).

In this sense, the aforementioned article intends to safeguard or,

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(109) Article 62.3 of the Act 7/1996, of 15 January, on Retail Commerce: Regulation of franchise agreements

"3. *Likewise, with a minimum anticipation of twenty days before the formalization of any franchise or delivery agreement or pre-agreement by the future franchisee to the franchiser of any payment, the franchiser shall have delivered to the future franchisee the necessary information, in writing, in order for the latter to be able to freely and in an informed way decide the incorporation to the franchise network and, namely, the main identification data of the franchiser, description of the business activity section to be franchised, content and characteristics of the franchiser and its exploitation, structure and extension of the network and essential elements of the franchise agreement. The rest of the basic conditions for the franchise transferal activity shall be legally established*".

(110) Article 3 the Royal Decree 201/2010, of 26 February: Pre-agreement information to the prospective franchisee.

"*At least twenty working days before the formalization of the franchise agreement or pre-agreement, or before the release of any payment to the franchiser by the future franchisee, the franchiser or the main franchisee shall provide the following truthful and not misleading information to the prospective franchisee:*

a) Identification data of the franchiser: name or company name, address and registration data in the registry of franchisers and, when it is a commercial company, the share capital of the last balance, indicating whether it is fully paid or in what proportion, as well as the inscription data in the Commercial Registry, where appropriate.

In the event that the franchisers are foreign, the franchiser shall also include the inscription in the mandatory registries of franchisers, in accordance with the laws of his/her country or State of origin. In the event of a main franchisee, the previous circumstances regarding his/her own franchiser shall also be included.

b) The accreditation in force of having been granted the ownership title or use license of the brand and distinctive signs of the franchiser body for Spain, as well as the filed eventual judicial appeals that may affect the ownership or the use of the brand, if any, stating, in any case, the duration of the license.

c) General description of the activity sector subject to the franchise businessthat shall include its most important data.

even, ensure the enforcement of the basic principle of the Spanish contractual system of the legal obligation of acting with strict compliance to the principle of good faith (111), which, according to certain precedents, includes the concept of economic public order (112).

Indeed, the cornerstone of the obligation to provide pre-contrac-

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d) The expertise of the franchiser company, which shall include, among other data, the creation date of the company, the main stages of its evolution and the development of the franchisee network.

e) Content and characteristics of the franchise and of its exploitation, which shall include a general explanation of the system of the franchised business, the characteristics of the know-how and of the permanent commercial or technical assistance which the franchiser shall provide his/her franchisees, as well as an estimate of the investments and necessary expenses for the commissioning of such a business. In the event that the franchiser provides the individual prospective franchisee with the forecast of sales figures or results of the business exploitation, they shall be based on experiences or studies sufficiently substantiated.

f) Structure and extension of the Spanish network, which shall include the way of organizing the franchise network and the number of establishments set in Spain, differentiating those that are directly exploited by the franchiser from those which operate under the franchise transfer regulation, indicating the place and the number of franchisees that are no longer part of the network in Spain in the last two years, stating whether it occurred due to the termination of the contractual period of due to other causes.

g) Essential elements of the franchise agreement, that shall gather the rights and obligations of the respective parties, duration of the agreement, resolution conditions and, if any, renewal conditions, economic compensations, exclusive covenants and limitations to the free disposal of the franchisee of the franchised business".

(111) Luis Díez-Picazo and Antonio Gullón, in *Sistema de Derecho Civil,* volume II, Editorial Técnos, ninth edition, 2005, page 64.

(112) See the Supreme Court of Madrid Ruling, of 28 January 2015, which includes the good faith principle in the concept of public policy:

"Outstanding paradigm of the principlewhich incorporated the economic public order is the general principle of good faith in contracting, expressly pointed out today by the Civil Division of the Supreme Court, under The Principles of European Contract Law — PECL, whose article 1:201, under the title Good faith and Fair dealing, states as a general duty that "Each party must act in accordance with the principle of good faith and fair dealing".

Principle of good faith whose enforcement is especially inexcusable when in a specific hiring there is an imbalance, disproportion or asymmetry between the parties, either in one of the cases, due to the consumer characteristic of one of these, or due to the complexity of the contracted product and the uneven knowledge that the respective contractors have of it.

In any case, there is no doubt that, in situations as such, the preservation of the principle of good faith has a status of public order rule, which is linked with the European public order, as stated by the case law of the European Court of Justice and, accordingly, the Plenary of the First Division of the Supreme Court. Such assimilation

tual information is to protect the franchisee, who is said to be in a situation of structural inequality regarding the franchiser; situation which, in certain instances, has even been compared to the one of consumers and users (113).

The protective spirit of the rule intends to protect the franchisee against the prospective consequences which may arise from an insufficient or inaccurate knowledge of the obligations to be undertaken through the signature of the franchise agreement. In fact, it is not unlikely to find cases where the franchisee intends to make the agreement ineffective based on a defect — mistake — in the presented consent.

In a correlative way, due to the relevance of the information subject to transmission, the rule imposes a duty of confidentiality to the franchisee so as to preserve the "business secrets" of the franchiser to which the former has access in compliance with the said obligation.

1.4. Essential elements of the agreement.

According to the provisions set forth in the Royal Decree 201/2010, the three essential elements of the franchise agreement — already included in the European Code of Ethics — are the brand, the know-how and the initial and continuous commercial and technical assistance the franchiser shall provide to the franchisees, those being elements which add great value to the contractual relation (114). We must point out that to these elements various covenants have to be added which, due to their recurrence, have still yet acquired the condition of configuring elements of the franchise agreement, such as the exclusivity covenant, the non-competence covenant (that can be

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cannot be unknown by this Division when ruling on the annulment or not of an arbitral award, namely due to public order violation...".

(113) Martínez Sanz, F., *De la actividad comercial en régimen de franquicia*, in *Régimen Jurídico General del Comercio Minorista.Comentarios a la Ley 7/1996, de 15 de enero, de Ordenación del Comercio Minorista y a la Ley Orgánica 2/1996, de 15 de enero, complementaria de la de Ordenación del Comercio Minorista*, Francisco José Alonso Espinosa, José Antonio López Pellicer, José Massaguer Fuentes and Antonio Reverte Navarro, coordinators, Editorial Mc Graw Hill. The franchise agreement is considered as a sort of adhesion agreement, as its articles function inthe same manner as the general conditions of contracting.

(114) Burgos Pavón, G. y Fernández Iglesias M.S., *La Franquicia*, Edición Píramide, 2nd Edition, Madrid, 2014, pages 27-29, 225-231.

subsequently extended to the termination of the agreement), confidentiality covenant, juridical relation covenants and nature of the agreement.

1.4.1. The brand.

Among the main obligations the franchiser shall meet, is the transfer of use of the brand and other industrial and intellectual property rights (brand, name, image, etc.). In this sense, the brand is constituted as an essential element of the franchise agreement as it includes the commercial name, the shop sign and all the corporate imaging which identifies the company in the market and makes it distinct from the competition (115) (116).

Therefore, prior to initiating the franchising activity, it is necessary for the franchiser to either be the registered owner of the brand or have the right to use and transfer the brand, as well as other rights that shape the image of the franchise.

Under franchise agreements, it is practice in Spain for the franchisee to grant a non-exclusive use license, without prejudice to the fact that he/she may transfer it exclusively for a specific territory or distribution channel. Furthermore, the franchiser shall, in compliance with his/her service, commit not only to keep the efficiency of the registry of the licensed brand or to carry out the corresponding renewals in case of having a use right, but also to preserve the competitive value of the brand and supervise that no third party makes illegitimate use of it or, in the event, to obtain specific means to cease the unconsented use of the right (117).

1.4.2. The "know-how".

The know-how as a characteristic and distinctive element of the

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(115) It is so disclosed by judgments of the Provincial Court of 22 January 2001, or the Provincial Court of Madrid of 21 March 2005.

(116) See Judgment of the Provincial Court of Madrid (11th Section) of 17 October 2011, establishing that the franchiser shall be the owner of the brand, either because he/she is the owner or because he/she has the exploitation rights of the brand granted.

(117) Sanchez, Solé, S., Ponce de León Cuñat, A., and Valle Zayas, O., *Capítulo 1: El contrato de franquicia*, page 517, in Ortega Burgos, E., *La Franquicia,* Edición Aranzadi, 2015.

franchise allows the franchisee to imitate the business model previously tested and experienced by the franchiser; this doubtlessly constitutes the essence of the franchise. For this reason, its definition is essential.

Such concept was regulated for the first time at EU level in the Regulation (EEC) number 4087/88 of the Commission, of 30 November 1998, regarding the application of section 3 of article 85 of the Treaty to franchise categories and agreements, being the definition of such rule based on the basic principles of the European Code of Ethics (118).

Article 1.3 stipulates that the know-how shall be understood as "*a set of non-patented practical knowledge, derived from the franchiser's expertise and verified by him/her, which is secret, substantial and identified*" maintaining such definition invariable throughout the years (119).

In the Spanish system, the Act 7/1996, of 15 January, on retail commerce, contains no reference to such concept. The Royal Decree

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(118) Article 3.1 of the REGULATION (EEC) No. 4087/1988 of the COMMISSION of 30 November, on the application of section 3 of article 85 of the Treaty to categories of franchise agreements — Official Journal No. L359 of 28/12/1988 pages 0046-0052, repealed by the REGULATION (EU) No. 2979/1999 OF THE COMMISSION of 22 December, on the application of article 81 of the EC Treaty to different categories of vertical agreements and concerted practices, which in turn was also repealed by the REGULATION (EU) No. 330/2010 OF THE COMMISSION of 20 April, on the application of article 101, section 3 of the Treaty on the Functioning of the European Union to certain categories of vertical agreements and concerted practices. The regulation states the meaning of the characteristic elements of the know-how: *"secret", the fact that the know-how, as a whole or in the configuration and assembling of its components, is not generally known or easily accessible; it is not limited to the strict sense that every individual component of the know-how shall be totally unknown or impossible to obtain outside the businesses of the franchiser; "substantial", the fact that the know-how shall include an important information for the sale of products or the provision of services to the final users, and in particular, for the provision of products for the sale, the transformation of products related to the provision of services, the relations with clients and the administrative and financial management. The know-how shall be useful for the franchisee, for him/her to be able, upon agreement termination, to improve his/her competitive position and, namely, improving the results or helping him/her to enter a new market; "identified", the fact that the know-how shall be described in a sufficiently comprehensive manner so as to allow the verification that it meets the conditions of secrecy and substantiality. The description of the know-how may be done under the franchise agreement, in a separated document or in any other appropriate manner.*

(119) Martínez-Franco, P., *Capítulo 2: El concepto del know-how*, in Ortega Burgos, E., *La Franquicia.* Edición Aranzadi, 2015, page 534.

201/2010, of 26 February, in its article 2.1.b) envisages "*the communication by the franchiser to the franchisee of certain technical knowledge or a know-how that shall be own, substantial and singular*" as essential element of the franchise contract.

In turn, the case law of the Supreme Court, in its Rulingof 21 October 2015 (120), among others, offers a large definition of the

(120) See the Supreme Court Ruling of 21 October 2005 (RJ 2005/8274) provides its definition, which follows: "*[...] the transmission of the know-how of the franchiser to the franchisee is a basic requirement of the franchise agreement under the European legislation and the case-law doctrine. In the case, the franchiser confirms its unauthorized use by the franchisees after factual termination of the agreement, while the latter denies even its existence. The principal problem lies in determining what is understood as know-how, whose translation in Spanish is "saber hacer", used in the European Regulation 4087/88 (LEC 1998, 1748), which derives from the French version "savoir faire", (as inRD 2485/98, of 13 November[RCL 1998, 2769]) -; even if it is worth mentioning that there is not a specific concept and that is varies in relation to the different franchise modalities and market sectors to which it refers to, or even when it operates autonomously. The doctrine underscores the evolution of its scope, which, firstly restricted to the "knowledge of industrial secrets", subsequently extended to those of "commercial nature", meaning, it began to be identified with secret knowledge indistinctly referred to the industrial or commercial scope, including the company's organizational aspects, — commercial secret. The tendency to a more general concept is also highlighted, in the sense of connecting the know-how with expertise — empirical nature knowledge (progressive acquisition, derived from the expertise in the development of an industrial or commercial activity, or derived from research and experimentation tasks) -, with the qualification of the specialist and with a lesser degree of confidentiality. Broadly speaking, it has been defined as "knowledge or body of technical knowledge that are not public domain and that are necessary for the manufacturing or commercialization of a product, for the provision of a service or for the organization of a business unit or branch, so it confers an advantage on those who have control on them over the competitors who make an effort to preserve them, avoiding its dissemination". It is worth mentioning as characteristics: the secret, understood as accessibility (it is not generally known or easily accessible, so part of its value lies on the temporary advantage which confers its communication to the franchisee or licensee), and an overall or global assessment, not related to the isolated elements, but to the articulated ones; substantiality, understood as the utility (competitive advantage); appropriate identification and patrimonial value (even if, in reality, it is included in the utility). Article 1.2, f) of the Regulation 4087/88 (applicable to the distribution franchises) defines know-how as the set of non-patented practical knowledge, derived from the franchiser's expertise and verified by the him/her, which is secret, substantial and identified, specifying these concepts in letters g), h) and i) of section 3 of article 1. In the case-law doctrine, the Judgment of 24 October 1979(RJ 1979, 3459) provides a descriptive concept stating that "what is dogmatically named "know-how", may aim at material and non-material elements, whether it is considered to be an asset in legal sense, determined for it being a factual situation consistent in the fact that the company's circumstances whichconstitute the object of the secret are unknown for third parties or in the fact that*

know-how and qualifies it as a basic element of the franchise contract, and defines it as a set of secret knowledge referred to the industrial or commercial area, including the organizational aspects of the company, being their characteristic features the following: (i) the secret, understood as difficult accessibility and global valuation, this is, not with a revelation of isolated episodes, but articulated ones, and (ii) the substantiality, understood as the utility (competitive advantage), appropriate identification and patrimonial value. In fact, the mentioned judgment, evoking the evolution of the concept of know-how, points out that it has gone from a first definition referred only to "secret knowledge of industrial scale" to also including the "knowledge of commercial scale".

Similarly, there are an abundance of Provincial Court Rulings which have decided upon the concept of the know-how, the most relevant decisions being the following: "Work methodology"; "operative techniques"; " previously tested commercial techniques"; "set of technical knowledge or commercialization systems owned by the franchiser"; "set of techniques and methods for the installation, commercialization and exploitation, identification in the presentation of the establishments, services provided, products, private policy" (121).

The transmission of this know-how takes place, principally, through two systems. On the one hand, (i) through the delivery of the Franchise Manuals (or Operative Manuals) upon formalization of the contract and (ii) on the other hand, through an initial training prior to the exploitation of the business which shall be followed by a permanent training throughout the duration of the agreement, which guarantees

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learning or acquiring expertise may be difficult or, given the fact that it is an asset in legal-technical sense, for having the specific characteristics of this idea, such as the patrimonial value and the body subject to legal businesses, integral part of an authentic immaterial asset". In the case law of the Provincial Courts, where there are numerous decisions on franchise agreements, there is a lot of literature pertaining to it and reference is made to the "work methodology"; "operational techniques"; "already experienced commercial techniques"; "set of technical knowledge or commercialization systems owned by the franchiser as a feature that differentiates it from other companies who trade in the same market"; "set of techniques and methods for the installation, commercialization and exploitation, identifying itself in the presentation of the premises, provided services, products, advertising policy, etc.".

(121) Martínez-Franco, P., *Chapter 2: El concepto del know-how*, in Ortega Burgos, E., *La Franquicia*, Edición Aranzadi, 2015, page 546.

the transmission of the evolution of the know-how to the franchisee (122).

The operations of the franchise are described in the mentioned Franchise Manual (123) and normally address and describe different areas of the business, including but not limited to, the business structure, the administrative management, the commercial management, the technical aspects concerning products and services, the operative procedures, control, supervision, and corporate image (124).

Furthermore, a series of obligations of the franchiser are enumerated with regard to the know-how, in accordance with the provisions set forth in article 1.3 of the European Code of Ethics, which, in short, are the following:

(i) The franchiser shall guarantee the use of this know-how which he/she maintains and develops to the franchisee. The franchiser shall transmit it to the franchisee and shall control its application and respect through appropriate information and training;

(ii) The franchiser shall foster the growth of information of the franchisees in order to improve the know-how.

(iii) During the pre-contractual, contractual and post-contractual periods, the franchiser shall impede any use and transmission of the know-how which may impede the Franchise Network, specifically concerning the competitors.

Thus, once the know-how has been transmitted, and as an integral part of the contract, the franchisee has the obligation to exploit the business in accordance to the guidelines, patterns and indications contained in the Manual, so as to safeguard a consistent image that reinforces and maintains the reputation and homogeneity of the franchise system and of its distinctive brands.

In this sense, the know-how and the knowledge collected by the franchiser are constituted as an essential element of the franchise agreement, allowing the case law to conclude that the lack of know-

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(122) Martínez-Franco, P., *Capítulo 2: El concepto del know-how,* in Ortega Burgos, E., *La Franquicia.* Edición Aranzadi, 2015, page 542.

(123) As established by Leloup, J-M., *La Franchise. Droit et pratique,* Éditions Dalloz, Paris, page 128, "*describing the development of the franchise operations and indicating the franchisee, in a simple way, the behavior that both him/her and his/her staff shall adopt in any usual circumstance in the functioning of a franchised company*".

(124) See the explanation of each one of the business areas: Martínez-Franco, P., *Capítulo 2: El concepto del know-how*, in Ortega Burgos, E., *La Franquicia*, Edición Aranzadi, 2015, page 539.

how may lead to an agreement breach subject to substantiate its resolution, having considered that the agreement may lack an object or further still a cause ([125]), ([126]) which may lead to its inefficiency. It is important to highlight, as stated by Ruling number 83/2010, of 30 December (AC 2010/747) of the Provincial Court of Madrid, that the obligation to transmit the know-how is considered fulfilled with, among other elements, the delivery of the Operation Manual to the franchisee and access to the franchiser's website ([127]).

Furthermore, in order to protect the proper functioning of the business, it is recommended, and perhaps essential, to include a confidentiality clause to protect the know-how of the franchise, possibility which is expressly permitted by article 5, final paragraph of the Regulation (EU) 330/2010 on the application of article 101, section 3, of the Treaty for the Functioning of the European Union (TFEU), to specific categories of vertical agreements and concerted practices, which allows the imposition of a restriction which is not limited in time regarding the use and dissemination of technical knowledge which is not public domain.

Nonetheless, if we take into account article 4 of the Royal Decree 201/2010, of 26 February, which regulates the commercial activity under franchise agreements and the notification of data to the registry of franchisers, we may conclude that the confidentiality obligation to which such article refers, appears to treat the exclusivity of pre-contractual information, excluding information provided during the franchise relation, stating that "the franchiser may demand, from the prospective franchisee, a confidentiality obligation regarding all pre-contractual information the franchiser receives or is going to receive".

Furthermore, we understand the protection of the know-how is inherent to the nature of the contract itself, being possible to demand

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([125]) In this sense, the case law is normally restrictive, as it considers that even with a little transmitted knowledge, there will always be brainstorming on how to run the business. Moreover, the agreement preservation principle governs. See Judgment of the Provincial Court of Saragossa, of 16 September 2003, to nullify the franchise agreement.

([126]) See the Provincial Court of Madrid Ruling, No. 104/2008, of 16 February.

([127]) See, also in relation to the existence of the know-how and its effective communication to the franchisee, the Provincial Court of Madrid Ruling, of 10 July 2007, the Provincial Court of Leon Ruling, of 4 November 2011, the Provincial Court of Alicante Ruling, of 29 May 2012.

it not only in the first pre-contractual phase, but during the validity of the agreement as well, and still once it has expired (128), (129), (130).

1.4.3. Training and technical and commercial assistance.

The third essential element of the contract is the initial and continuous assistance which the franchiser shall provide to his/her franchisees, which includes the obligation of periodical training (131). It is so stated in the Provincial Court of Leon Ruling, of 4 November 2011 declaring that: "*The purpose of the obligation to train is to coach, prepare and train the franchisee in the exploitation of the business model of the company for the contractually agreed purpose*". In accordance to the aforementioned, the franchiser shall meet this obligation throughout the validity of the contract, operating such training, both as a way of transferring the know-how, and as a way to ease the provision of the continuous technical and commercial assistance required under the contract — cfr. art. 1258 CC.

Likewise, and with the purpose of guaranteeing an appropriate exploitation of the business, the Royal Decree 201/2010, of 16 Febru-

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(128) In this sense, the clauses described in the old Regulation (EEC) No. 4087/88 of the Commission, of 30 November are common.

"*3.2.a) not to disclose the know-how communicated by the franchiser to third parties. The franchisee may likewise be bound to respect this clause after the termination of the agreement.*

3.2.d) not to use the know-how provided by the franchiser for purposes other than the exploitation of the franchise; the franchisee may be bound to respect this clause after the termination of the agreement."

(129) See articles 57 of the Code of Commerce and 1258 of the Civil Code.

(130) Sánchez Solé, S. Ponce de León Cuñat, A., Valles Zayas, O., *Capítulo 1: El contrato de franquicia,* in Ortega Burgos, E., *La Franquicia*, Edición Aranzadi, 2015, page 508.

(131) The Provincial Court of Leon Ruling (2nd Section) No. 326/2011, of 4 November, (JUR 2011/424178) states the following explanation of counseling and support to the franchisee: "*And regarding the provision of counseling and orientation related to the training and management of staff dependent of the franchisee, in its premises, we shall agree with the criterion of the district hearing body that it shall not be necessarily on-site since, as it has been already stated regarding the pre-agreement information, new technologies also allow new possibilities of compliance regarding the compliance of this counseling obligation. In this regard, the list of the phone calls and emails provided by the defendant (document number six) that largely ensures the compliance by the franchiser of its counseling and continuous training obligation is important*".

ary, states, among the obligations of the franchiser, the "*continuous provision of a commercial and/or technical assistance of the franchiser to the franchisee throughout the validity of the agreement; all this without prejudice of the supervisory powers that may be contractually agreed upon*".

Such assistance is placed in a parallel to the control and supervision undertaken by the franchiser, with the purpose of both guaranteeing the homogeneity of the activity, and preventing mistakes in the business' operations.

2. Validity of the agreement.

Regarding the validity of the agreement, it is necessary to respect the provisions agreed upon the contractual parties. It may be of a determined or open-ended duration (132). In practice, as recommended by most codes of ethics, generally and except in special cases, the duration of the contract is determined and certain more or less extensive terms are set, which allow the reimbursement of the investment by the franchisee. Generally, the duration agreed *ab initio* is five years (133).

Without prejudice of the above, it is also a usual practice that along with this disposition, the parties agree upon the tacit renewal of the contract for subsequent periods (134) — or it may even take place due

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(132) General Council of the Judiciary, Judicial Academy, Judicial Law Notebooks: *Contrato de agencia, distribución y franquicia*, Madrid, 2007, page 258, points out that "the duration of the franchise agreement is left to the parties. The termination of the contractual relation may thus be due to: a) the termination of the agreement due to the expiry of time for which the duration of the agreement was established in case that the time was agreed upon; b) the parties' will; c) the unilateral termination by either of the contracting parties, in which case we shall distinguish between the agreements of specific duration and the undetermined duration ones for not having been confirmed in writing within the term or duration of the agreement; d) as a consequence of the complaint filed by one of the parties on the breach of contractual obligations by the other party; or e) due to circumstances occurred unexpectedly that affect the capacity and/or the personality of the parties, affecting the object of the legal business.

(133) Sanchez, Solé, S., Ponce de León Cuñat, A., Valle Zayas, O., *Capítulo 1: el contrato de franquicia*, in Ortega Burgos, E., *La Franquicia*, Edición Aranzadi, 2015, pages 502-503.

(134) Lázaro Sánchez, Emilio J., *El contrato de Franquicia (aspectos básicos)*, Anales de Derecho, Universidad de Murcia, number 18, 2000.

to the efficiency of the acts of the parties — which may ultimately cause that the contract, initially agreed upon for a fixed period, results in an open-ended duration contract.

In the absence of an extension, the agreement shall cease to be valid upon the agreed date. Nevertheless, it is important to stress that there is a doctrinal position that tends toward (i) considering the need of the franchiser to issue a prior termination notice in advance to the agreed termination date and (ii) an extension right in favor of the franchisee, so as to prevent the resolution to hinder the reimbursement of the investment made to be part of the franchise's commercial network (135), (136).

In the event that the agreement's duration is open-ended, because it has been so agreed or, if the duration is not mentioned, the parties shall have the right to terminate it at any time, respecting in any case the principles of good faith, contractual loyalty and respect to the set prior notice terms — or that they are reasonable given the concurrent circumstances — so as to avoid situations of abusive exercise of the law, which may derive in damages. In this sense, "*the unilateral cancellation by either of the parties may terminate the agreement, given the fact that a perpetual connection is unacceptable*" (137), a solution that the case law of the Supreme Court — in the absence of legal and contractual stipulation thereon — admits in case of contractual relations based on the mutual trust of the parties (138).

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(135) Gallego Sánchez, E., *La Franquicia*, Editorial Trivium, SA, 1991, establishes that the basis of the aforementioned has its origin in the "*social function of the Law, understood in these cases as the safeguard of the fundamental elements of the intermediate company, [...], an orientation based on certain case-law sector (French), stating that, while the agreement demands substantial investment from the distributer, [...] the need for its depreciation requires certain stability of the contractual relations between both parties and, therefore, it takes into account the existence of an abuse when the duration of the agreement has not allowed the franchisee to recoup them*".

(136) See, for that purpose, Section 4.2 and 5.2 of our work on the distribution agreement in this document.

(137) With the analogical application of the Law of Agency Agreement: its article 25 LCA includes the possibility of both parties to report it in the event that the duration is undetermined, but they shall give a minimum prior notice of a month per year of validity, with a maximum of six months.

(138) See, to this purpose, Section 4.3 of our work on the distribution agreement in this document.

3. Termination of the agreement. Minimum purchase clause (139).

3.1. Termination of the agreement.

Given the complex and atypical nature of the franchise agreement, it is especially relevant to expressly regulate the issues related to the termination, expiration and expiration of the legal relation.

The termination causes include, but are not limited to:

(i) Term of the contract: in the case of an ordinary termination of the contractual relation by means of which the contract is terminated in a specific term or duration.

(ii) Termination due to contractual breach by either of the parties: the termination of the franchise agreement may also occur, for just cause, in the event of a contractual breach by either of the parties (140). In this sense, the breaching party shall pay the corresponding damages and claims that this may have caused to the other party.

(iii) Being the franchise contract bilateral, article 1124 of the Civil Code (141) is applicable, which offers the complying party an *ius eligendi*, which enables him/her to (i) either demand the obligatory compliance (ii) or urge the contractual termination, and in both cases, require compensation for damages caused and/or, in case it was agreed,

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(139) In this section, we integrally refer to the considerations made in the chapter on distribution agreement and, specifically, on section 4.5 thereof.

(140) See the Provincial Court of Barcelona Ruling (13th Section) No. 282/2008, of 13 May, JUR 2008/205213, which indicates "*The resolute action is set as a measure (either dissociate from or terminate the relation) granted by law to the parties of the mandatory relation (fulfilled) as a protection of its interest, as a consequence of the non-compliance by the other party, having the possibility (as a sanction to the non-complier) to indemnify for the damages. Such authority (rather than "condition") is considered implicit (tacit or understood) in the reciprocal obligations, based on the contractual equity and junction with the loyalty and compliance duties (pacta sunt servanda)*".

(141) Article 1124 of the Civil Code:

"*The power to terminate obligations is deemed to be implied in reciprocal obligations, where one of the obligor's should not perform his obligation. The aggrieved party may choose between demanding performance or termination of the obligation, with compensation of damages and payment of interest in both cases. He may also request termination, even after having chosen specific performance, where the latter should be impossible.*"

demand the compliance of the conventional criminal clauses that may ensue and which cannot be substitutive of the damages and claims (142).

(iv) In order to be able to urge the contractual resolution, it is necessary for the breach to be severe, substantial, be related to the essential elements of the contract and reiterated (143), as repeatedly stated by the legal doctrine, which is utterly applicable to the circumstance, given that, already stated, the Spanish regulation does not envisage a precise specific provision regarding the franchise agreement (144).

(v) Unilateral withdrawal of one of the parties: in case of open-ended duration agreements, as already mentioned, — see previous section 3 — the case law admits the unilateral claim of either of the contracting parties through a unilateral statement of intent that takes effect on receipt, not being it necessary for there to be a fair reason. In this sense, the application of the general principle of law — see article 1583 CC- is put into practice. According to this right, none of the parties may remain linked *sine die* by a contractual legal relation.

(vi) Mutually agreed termination: the contracting parties may, in any case, mutually agree to terminate the franchise agreement on the basis of the freedom of choice of the parties (145).

4. Termination of the Franchise agreement.

4.1. Compensation for damages and claims.

The termination of the franchise agreement due to breach results,

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(142) Ruiz de Villa, J and Masuet Iglesias, L., *Capítulo 7: Consecuencias del incumplimiento del contrato*, in Ortega Burgos, E., *La Franquicia*, Edición Aranzadi, 2015, pages 649-654.

(143) See Judgment of the Supreme Court of 23 February and 13 July 1995, which states, in order to be able to urge the contractual termination, it is necessary "*to not have a decisively rebellious will, but the concurrence of situation of the agreement frustration, because the non-compliance has to be so big that hampers the normal termination of the agreement*".

(144) See the Supreme Court Ruling (Civil Division, 1st Section) No. 159/2008, of 3 March. RJ 2008/2935.

(145) Article 1255 of the Civil Code:

"The signatories may establish the covenants, clauses and conditions that they deem appropriate, provided that are not against the law, the ethics or the public order".

by law (pursuant to articles 1101, 1103 and 1124 of the CC), in the right to be compensated for damages and claims, which shall be determined — accrual and amount — by means of an agreement or judicial resolution (146).

In accordance with articles 1101 (147) and 1106 (148) of the Civil Code, the extent of the compensation for damages derived from the contractual breach include: loss of profit, consisting on the value of the loss that has been suffered, enforceable where there is a causality relation between the contractual breach and the profit lost, such as the profit that the creditor has ceased to receive, as well as the emerging damage (149).

The elements of the franchise give a particular nature to the damages that may have been caused in the context of a franchise relation.

Given their specificity, we will now focus on these last aspects.

4.2. Damages due to lack of notice and, eventually, due to non-returned investments (150).

As aforementioned — in the previous section 3 —, in agreements of indeterminate period, the case law demands that the claimant issues the corresponding notice of termination on time, which allows the other party to reorganize its commercial activity. According to consistent case law, the principles of loyalty and good faith are considered to be maintained. These principles shall govern every contractual relation.

In the event of breach of the duty to issue the corresponding prior notice or in case of it not being enough, the case law has favored the

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(146) Ruiz de Villa, J. and Masuet, Iglesias, L., *Capítulo 7: Consecuencias del incumplimiento del contrato.* in Ortega Burgos, E., *La Franquicia*, Edición Aranzadi, 2015, page 651.

(147) Article 1101 Civil Code: "*Persons who, in the performance of their obligations, should incur in willful misconduct, negligence or default, and those who in any way should contravene the content of the obligation shall be subject to compensation of any damages caused*".

(148) Article 1106 of the Civil Code: "*Damage compensation comprises not just the value of the loss suffered, but also that of the gain which the creditor has failed to obtain, save for the provisions of the following articles*".

(149) Carrasco, Perera, A., *Derecho de Contratos*, Editorial Aranzadi, Pamplona, 2010, page 1103.

(150) In order to avoid repetitions, we refer to the aforesaid in Sections 4.2, 4.3 and 5.2 of our work on the distribution agreement in this document.

granting of the corresponding compensation, in which case its scope or the compensable damages shall not be reduced to emerging damage — contrary to what would happen to the those investments which have not been amortized by the franchisee at the time of the contract termination — but they shall also be considered as loss of profit, as envisaged in the aforementioned article 1106 of the Civil Code. In such cases, the case law considers loss of profit the patrimonial increases that the creditor may have obtained and that have been thwarted due to the action of the claimant during the period between the date of the termination and the date of the termination in a regular way in the event that there had been prior notice or it had been issued in a timely manner.

In this regard, the Judgment of 7 March 2005 of the Provincial Court of Barcelona, among others, states that "*the issue is that when the termination of a contract is unjustified, contrarily to what represents the principle of good faith, in a way that may be considered abusive, benefiting the grantor and damaging the distributor, the remediation is imposed through the recognition of the appropriate compensation, which, otherwise, does not necessarily need to respond the strict criteria and scales of the Act of Agency Agreement*" (151).

4.3. Compensation for clientele (152).

4.3.1. Concept of legal nature.

The lack of specific regulation for the franchise agreement shows certain problems which affect the compatibility of this contractual category with the generation of the compensation for clientele (153) — specific institution of the agency agreement — which may lead to the

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(151) This last assertion shall be tempered according to the criterion of the most recent precedent and that are subject to analysis in Sections 1.3 and 5.3 of our work on the distribution agreement in this document.

(152) For a detailed study of the compensation for customer in the context of the agency agreement, we refer to various authors: "Termination of agency contract: termination indemnity" published by the CRINT (COMMISSIONE RAPPORTI INTERNAZIONALI) of the bar of Milan (Ordine degli Avocatti di Milano).

(153) It is regulated under the Spanish regulation through the Law 12/1992, of 27 May, on Agency Agreement (LCA), ruling through which the Directive 86/653/EEC of the Commission, of 18 December 1986 is included in our positive law.

termination of the agreement. This issue has generated and generates recurring disputes before the courts.

The doctrine and case law do not agree on how to address the problem which generates the analogical application (154) of the Agency Agreement Act toward the termination of the franchise agreement, given their atypical nature, especially because the concurrence of the requirements under article 4.1. CC is not clear allowing referring to the analogy (*legis*).

Those who advocate for the analogy usually resort, among others, to the argument that the agency and franchise agreements share a similar economic function and are integrated, along with the commercial distribution or concession agreement, in those which, according to a recurring doctrine classification, are included in the category of "distribution agreements" or "cooperation agreements". Such doctrinal sector concludes that in both agreements there is a true commercial integration and that the customers shall be considered as a common asset that shall be settled between the parties when the integration is suppressed.

Simultaneously, there is another doctrinal sector which opposes the analogical application of the Agency Agreement Act (LCA, by its Spanish acronym), mainly grounding their position on the differences presented by both contractual types. It is especially remarkable the acting in the name and on behalf of the franchisee, as well as the different compensation systems in each agreement.

The fact that the franchisee, upon being integrated in the commercial network of the franchise, benefits from a renowned brand is added to this last argument, concluding that the goodwill lies on the brand and the commercialization methods specially designed by the franchiser (155). This last aspect affects the capacity of the franchisee to make its own customer base, which, at the same time, is one of the requirements which shall necessarily occur to grant the compensation for clientele in the context of the agency agreement.

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(154) Article 4.1 [Analogy and supplementary character of the Civil Code]

"*1. Where the relevant rules fail to contemplate a specific case, but do regulate another similar one in which the same ratio is perceived, the latter rule shall be applied by analogy*".

(155) In this regard, we refer to the analysis of the different dogmatic positions under Sections 1.3 and 5.3 of our work on the distribution agreement in this document.

4.3.2. Budgets.

The Supreme Court has requested, to assess the analogical application of article 28 (156) of the Agency Agreement Act, the concurrency, in a cumulative way, of the requirements indicated below:

(i) Termination of the agreement: The right to compensation for clientele operates independently of the cause of the termination of the agreement, unless it refers to any of the cases mentioned in article 30 of the LCA, which would imply the existence of such right:

a) When the business person terminates the agreement due to a breach in the legal or contractual obligations (157).

b) When the franchiser has abandoned the contract, unless the causes of such abandonment were attributable to the businessperson, or was based on the age, invalidity or illness of the agent and it was not possible to reasonably demand the continuity of the activities.

c) When, without the businessperson's consent, the franchiser had transferred his/her rights and obligations to a third party, by virtue of the agency agreement.

(ii) Provision of new customers to the businessperson or substantial increase of the operations with the existing customers: One must consider two situations: (i) when starting from scratch, there should be no problem when establishing the provision of customers. Nonetheless, in the case where (ii) there is a pre-existing customer base and, upon agreement termination, parts of those customers are lost, two other theories arise to determine whether the requirement in question is met. The first supports the fact that such requirement shall not concur when

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(156) Article 28 of the Agency Agreement Act: Compensation for clientele

"*1. When the agency agreement is terminated, whether the duration is fixed or open-ended, the agent that has provided new customers to the businessperson, or that has notably increased the operations with the existing customers, shall be entitled for a compensation if his/her previous activity can still result in important advantages for the businessperson and it is fairly appropriate given the existence of competence limitation covenants, the lost commissions or any other circumstances that may arise.*

2. The right of compensation for customers also exists in the case that the agreement is terminated due to decease or declaration of death of the agent.

3. Under no circumstance shall the compensation exceed the annual average amount of the payments made to the agent during the last five years or, throughout the duration term of the agreement, if it were inferior".

(157) Ruling 560/2012 of the SC, 1st Civil Division, of 2 October 2012 (RJ 2012, 10121) and Ruling 904/2008 of the SC, of 15 October (RJ 2008, 7126) have made a stand in this regard.

the global computation results in a loss of the number of customers (158), while the second supports that the agent shall have the right to compensation for customers if he/she has provided new customers for the businessperson (159).

Regarding the substantial increase in the operations, the Act demands the increase of global computation of operations with the customers *inherited* from the businessperson and resulting in a greater turnover, regardless of the clients who may decrease their amount of orders.

(iii) The previous activity may continue to report important advantages for the businessperson: it is vital for the commercial relations created to continue in the future and are subject, as such, to producing substantial and important benefits for the businessperson. In this sense, the doctrine of the Supreme Court states that the agent cannot be requested to bear the burden of proof that the businessperson will continue to obtain relevant and transcendent profit of the actions carried out by the agent, because the proof of future profits is excessive and difficult. It should be specified that such burden goes beyond the provisions under article 28.1º of the LCA which uses the term "may", stating, in this sense, the case law doctrine that treats making a reasonable prognosis on the likely behavior of future customers (160).

(iv) Equity: the equity judgment shall be applied in those cases where the factual assumptions under article 28 LCA, i.e. provision or increase of the customer base and its future use, and it shall be used, in any case, to moderate the compensation. In this sense, the Act provides, in an alternative way, a series of requirements which will play in the interest of the granting of compensation for clientele. These include, but are not limited to: the existence of covenants to limit the competence and the commissions that the agent (franchiser) will lose. Further, the weighing of other concurrent circumstances such as the agent agreement's antiquity, the implementation of the brand, etc.

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(158) Moxica Roman, J., *La Ley del Contrato de Agencia,* Editorial Aranzadi, S.A., 1998, page 32.

(159) Martínez Sanz, F., *La indemnización por clientela en los contratos de agencia y concesión*, Editorial Civitas, 1998, pages 147 to 162.

(160) See Ruling 343/2004 of the SC, of 30 April, (RJ 2004/1678), on "*the issue that the customers addressed by the businessperson may continue to cause important advantages, has stated that reference is made to the susceptibility by the businessperson to continue to take economic advantage and it is rather a reasonable prognosis on a customer behavior that is still likely (Judgment of 7 April 2003[RJ 2003, 2951])".*

The Supreme Court in its Ruling 341/2012, of 31 May, (RJ 2012, 6549), among others, establishes that the equity judgment in the determination of the origin of the compensation for customers under section 1 of article 28.1 LCA shall also reach the fixation of the compensation's amount, without prejudice of the fact that it shall, in any case, respect the legal limit under section 3: "*under no circumstances shall the compensation exceed the average annual amount of the remunerations received by the agent throughout the last five years or throughout the duration period of the agreement, if the latter was inferior*".

4.3.3. Analogical application of the Agency Agreement Act and case law analysis.

The special characteristics of the franchise agreement, its atypical nature and the lack of specific regulation have caused for certain precedents to refer to the doctrinal body created according to the interpretation of article 28 LCA, and maintain its analogical application to the franchise agreement, so as to analyze the opportunity to grant the compensation for customers in favor of the franchisee once the agreement is terminated.

Essentially, the case law and the doctrine have addressed this issue from a double perspective. Firstly, when facing cases where the parties agreed in the contract on the applicable regime of its liquidation upon termination and, therefore, they agreed the compensation consequences derived from such termination. Secondly, it includes those cases where such a covenant does not exist.

(i) *Existence of an express covenant*

The principle of covenant freedom governs as a general rule in the franchise agreements (161). Given the lack of specific regulation in the matter, the general contract act is applicable, whose nature is essentially operative. Therefore, only in the absence of an express contractual regulation, other regulations could be referred to (162).

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(161) See the Supreme Court Ruling of 27 September 1996 (RJ 1996, 6646), which states that as an atypical agreement, it shall be governed by the will of the parties reflected in the contractual clauses, and only for those cases where there are interpretation vacuums "*it shall be necessary to use figures of similar agreements*".

(162) Article 1255 of the Civil Code: "*The contracting parties may establish any covenants, clauses and conditions deemed convenient, provided that they are not contrary to the laws, to morals or to public policy*".

Given the aforementioned, it shall be inferred that the exclusion by means of the express covenant on the compensation for clientele in favor of the franchisee upon franchise agreement termination, should not only be valid, but it should also prevail on the analogical application of the compensation for clientele under articles 28 LCA (163). As stated below, this premise has been nuanced by a sector of the case law.

It was so declared by the Supreme Court, among others, in its Rulings of 15 January 2008 (RJ 2008, 1393), of 15 October 2008 (RJ 2008, 6914) and of 21 January 2009 (RJ 2009, 552), of which results that the analogical application, or that inspiring article 28 LCA, is only valid when such agreement does not contain "any anticipation on the liquidation of relations between the parties upon agreement termination" (164).

In the same line of argument, the Supreme Court Ruling, 1st Division, of 32 July 2007, (RJ 2007, 6093) explicitly recognizes the validity of the covenants which exclude the compensation for customers when stating that: "*a claim for enrichment with no customer utilization cause cannot exist when its utilization regimen is included in the agreement*" (165).

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(163) Supreme Court Ruling 904/2008, of 15 October (RJ 2008, 7126).

(164) Article 1258 CC: "*Contracts are perfected by mere consent, and since then bind the parties, not just to the performance of the matters expressly agreed therein, but also to all consequences which, according to their nature, are in accordance with good faith, custom and the law*".

(165) Specifically, "*this Division, in its most recent statements, understands that the obligation to compensate for a use of the customer base is based on the exercise of an action derived from the existence of an investment conducted in view of frustrated expectations due to the termination of the agreement (investment requirement condition), founded in the existence of unjust enrichment, namely when, as in the distribution agreement, it is not subject to an express legal stipulation (Judgments of the SC of 5 May 2006, 22 September 2006, 29 September 2006 and 23 March 2007).*

[...] The case law repeatedly states that the unjust enrichment is an institution with subsidiary nature that shall give in to a legal or contractual stipulation. [...]

[...] It is not possible to talk about the existence of a waiver of rights, since the duty to compensate for the use of the customer base, not legally established under the distribution agreement, is based, as already examined, not on a legal right corresponding to the distributer, but in the concurrence of the requirements determining an unjust enrichment, as a situation that legitimizes for the exercise of a restitution condition or action, and such enrichment does not exist when applying a contractual regulation that determines the mutual obligations of the parties in relation to the considered benefits, whose acceptance does not entail any sort of abandonment by the owner of a subjective right granted by law (this is considered as a waiver by the Judgment of the SC of 30 October 2001[RJ 2001, 8139])."

However, in this last aspect, it shall be taken into account that the agency agreement regulation is of eminently imperative nature, and the right for compensation for clientele cannot be waived by the parties, thus protecting the agent, party which is considered to be the structurally the weak party of the contractual relation.

Subsequently, such imperative nature of the standard has caused problems with the analogical application to the contract, since it is considered that the franchisee enjoys autonomy, acts independently and has a proper business structure (166). In essence, as we have stated, when mentioning the "ordinary" distribution agreement, the same ratio under article 4.1 CC is not clear for the appeal to analogy *legis* to be legitimate.

Therefore, as materialized in the context of the distribution agreement, the analogical application of the LCA is defended in a case-study way, non-automatic and provided that there is no a covenant of express waiver (167). This last aspect shall be nuanced. In fact, the dominant case law has stressed that, even if the waiver of compensation in the contract shall be taken into account, it is not decisive to exclude the compensation *per se*. It is clear, in this sense, that there exists a strong trend towards the analogical application of the Agency Agreement Act — it appears that its imperative nature imposes its application, even under those cases not subsumed in such standard, which we believe is highly objectionable —, even if in every of the considered cases the amount of the claim for compensation of the franchisee has been reduced, for it is ordinarily considered that, in the attraction of customers, the advertising of these products, their quality, actions and merits have been decisive, since, given the structure of the franchise agreement, they are attributable to the Franchiser. Regarding this last aspect, we claim that it becomes clear once again that there is a lack of the same ratio between both agreements, which should just impede the analogical application under LCA and forces to introduce very signifi-

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(166) Alonso Soto, R. and Sánchez Andrés, A., *Los contratos de distribución*, in Menéndez, A. and Rojo, A. *Lecciones de Derecho Mercantil* (Vol. II), Civitas, Pamplona, 2012.

(167) Martínez Sanz, F., *La indemnización por clientela en los contratos de agencia y concesión*, Civitas, Madrid, 1995.

cant nuances, such as, in this case, the need to weight the circumstances shown to fix the compensation amount. (168)

(ii) *Absence of an express covenant*

The cases in which there is an absence of covenant which are subject to compensation for clientele are those that generate greater doctrinal and case-law disputes. This has led to a controversy between supporters and opponents to grant the franchisee a compensation for customers upon termination of the contractual relation.

One sector of the doctrine and the case law contend the analogical application of the compensation for customers upon termination of the franchise agreement, provided that the provisions under article 28 LCA are effective.

The Supreme Court Ruling number 697/2007, of 22 June (RJ 2007, 5427) is especially informative of this doctrinal trend — given the study and quotes it provides from many other Judgments. This Judgment states that "*the so-called compensation for clientele is not exclusive of the agency agreement and, despite the structural differences with other legal instruments used by the businesspeople for the distribution of products it may be appreciated in other agreements*". With this statement, the Supreme Court seems to be opening the door for the analogical application under article 28 of the Act of Agency Agreement towards the franchise agreement.

Likewise, Ruling number 357/2009, of 1 June, of the Supreme Court (RJ 2009/3191) acknowledges the right of the franchisee to obtain a compensation for customers, given that "*factually, the franchiser recognizes the utilization of the increase in the customer base and, legally, there does not seem to be inconsistencies with the concept of loss of profit, responding to different perspectives, without the established "quantum" being disproportionate*" (legal basis 4). In the same line, we find the Judgment of the Supreme Court of 22 October 2012 (RJ 2013, 1539), which acknowledges a compensation for customers to the franchisee by lapse of time alone (169).

The *ratio decidendi* in which the pronouncement of the aforemen-

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(168) Martínez, Picazo, G. and Pardo de Andrade, J. G., *Capítulo 1: Normativa y Deontología. Marco Legal español. Aplicación e interpretación jurisprudencial*, in Ortega Burgos, E., *La Franquicia.* Edición Aranzadi, 2015, page 344.

(169) See other Rulings supporting the analogical application, such as: the Provincial Court of Barcelona Ruling (14th Section), of 10 June 2004, the Provincial Court of Madrid Ruling (19th Section), of 29 April 2010, the Provincial Court of

tioned resolutions lies, is the same principle as the one advocated by the European Act in the implementation of a "compensation for clientele" to all commercial agency, franchise or commercial distribution agency agreements. Likewise, the Principles of the European Act state that a compensation shall be provided upon agreement termination, regardless of the termination cause (including the non-compliance by either of the parties) if (a) the counterpart considerably increased the turnover of the other and the latter continues obtaining substantial profit from this activity; and (b) the payment of a compensation seems reasonable taking into account all the circumstances (arts. 1:305 Principles of European Act. Commercial Agency, Franchise and Commercial Distribution and IV.E.-2:305 Draft Common Frame of Reference) (170).

Likewise, the case law has based the granting of the compensation for customers pursuant to the inequitable enrichment doctrine (171), in those cases in which the parties have agreed upon the possibility to terminate or withdraw from the agreement *ad nutum*. It has been so acknowledged by the case law of the Supreme Court, but demanding on the one hand the enrichment of the franchiser and, on the other hand, the correlative impoverishment of the franchisee and, in any case, failure of consideration, so that the inequitable enrichment appeal may apply (172). The Rulings of the Supreme Court of 27 May 1993, 16 October 1995, 10 December 1996, 23 June 2005, 21 November 2005, 9 February 2006 and 16 May 2007, among others, have judged in the same line.

Opposite to this case-law position, there is another doctrinal sector which is against recognizing the compensation for clientele, as they consider that the analogical application of article 28 LCA is not

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Madrid Ruling (14th Section), of 5 May 2010 and the Provincial Court of Madrid Ruling (8th Section), of 12 March 2012.

(170) The Provincial Court of Navarra Ruling (3rd Section) No. 195/2009, of 9 December (JUR 2010/187298) (legal basis 2º). That same ruling also points out that: "*If, generally, in the commercial agency there is an increase of the customer base by the agent, in the franchise and the distribution it may be less likely that the compensation is applicable, given that the client is normally attracted to the main product or the brand, rather than by the activity of the franchisee. Therefore, an origin and an amount are fixed for the agent's compensation, while the distributor's and the dealer's are subject to case-by-case assessment and with no prefixed rules for the amount*".

(171) Parra Lucán, M. A., *Los cuasicontratos*, in Martínez de Aguirre, C., *Curso de Derecho Civil (II), Derecho de Obligaciones*, Colex, Madrid, 2011.

(172) See the Supreme Court Ruling of 28 January 1956, of 30 March 1988, of 28 March and 15 November 1990, and 2 January 1991.

appropriate, since there is not enough of the same ratio between both contractual figures. Particularly, it means that the customer base, contrary to the agency or distribution agreement, is created by the customers themselves, who are attracted by the image, the reputation and prestige of the franchiser brand rather than by the effort and recruitment actions of the franchisee (173).Therefore, the requirement of significant increase of the customer base given the franchisee's activity would not be present.

In this line, the Provincial Courts show diverging criteria, being the rulings against the analogical application of the LCA numerous (174).

Nonetheless, despite there being a significant number of Rulings against, it is particularly noteworthy that the Provincial Court of Barcelona, of 10 June 2004 (AC 2004/1100), introduces important nuances when pointing out (in its legal basis number 7) that "*the provision under article 28 of the agency agreement is not applicable as it is necessary to take into account that the product covered by the franchise, given its reputation, exempts the franchisee, who is advertised thanks to the franchiser, from a great part of the dissemination and customer acquisition, so the profit that the defendant may have generated for the customer can only be regarded as derived in a small part from the activity of the franchisee*", which ultimately serves as basis to moderate the compensation for customers (175). In line with the above, and as

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(173) See the Provincial Court of Alava Ruling of 10 April 2006 (AC 2006, 899), Provincial Court of Tarragona Ruling of 30 January 2008 (JUR 2008, 146713) and the Provincial Court of Burgos Ruling of 2 December 2011 (JUR 2011, 440702).

In this regard, the Ruling No. 697/2007 of 22 June (RJ 2007/5427) (3rd legal basis) states that: "*The analogical application is contested, in this case, on the basis of denying the granting of traditionally demanded estimates for the analogical application: existence of a legal vacuum, potentially expansive nature of the ruling and same ratio. The argument seems to reproduce the reasons that some authorized opinion has given against the analogical application of the LCA precepts, with regards to the compensation for customers, in the scientific doctrine. Nonetheless, they are not decisive and they reveal a technical treatment that could be described as formalist*".

(174) See the Provincial Court of Valencia Ruling (6th Section) of 28 April 2000, the Provincial Court of Malaga Ruling of 30 November 2005, the Provincial Court of Alava Ruling (1st Section) of 10 April 2006, the Provincial Court of Tarragona Ruling (1st Section) of 30 January 2008, the Provincial Court of Burgos Ruling (3rd Section) of 2 December 2011.

(175) See, also, the Provincial Court of Barcelona Ruling, of 13 May 2008, 13th Section (JUR 2008, 205213) and the Provincial Court of Navarra Ruling, 3rd Section, of 9 December 2009 (JUR 2010, 187298).

indicated in the Judgment of the Supreme Court of 15 January 2008, "*[...] the plaintiff who intends to receive such compensation shall prove the effective customer acquisition and the potential of use by the grantor. The Courts shall likewise weight all the case's circumstance, such as the integration, or not, of the grantor in a commercial network that significantly aligns its position to the agent's*".

In conclusion, and despite the existent different case-law positions, we can assert that it has become apparent that the Spanish case law acknowledges a prospective right of the franchisee to obtain a compensation for customers, provided the following is met: the non-existence of an express agreement waiving the compensation, the complete termination of the contract and the proof that customers have been acquired for the business, along with the fact that the prospective use by the franchiser and the weighing of the circumstances concurring in the case results in an equitable compensation (176).

(176) Martí, Miravalls, J., *El Contrato de Franquicia*, in Ruíz de Villa, J. and Masuet Iglesias, L., *Capítulo* 7: *Consecuencias del incumplimiento del contrato*, page 563, in Ortega Burgos, E., *La Franquicia.* Edición Aranzadi, 2015, page 663.

THE AUTHORS

Alberto Venezia

Alberto Venezia, member of the Milan Bar since January 1995, has founded in 2006 the Italian law firm *Alberto Venezia Avvocati*, which operates with consolidated expertise in the field of private law, commercial law and international law, with particular expertise in contracts and litigation concerning distribution networks in all economic and financial sectors.

Commercial agency agreements, insurance agency, financial services agency, financial advisory services, franchising, distributorship agreements, business procurement, selective distribution and mediation are specialization areas in which operates the founder and the law firm, both in out-of-court consultancy — aimed at the creation, correct administration and application of national and international contracts — as well as in litigation, both before the courts and in arbitration.

Alberto Venezia has published many articles and comments for financial dailies and law journals and has taught on several occasions including seminars, masters courses and conferences at Universities, chambers of commerce and institutions based in Italy and abroad.

He works in Italian, English and French.

www.albertovenezia.it
av@albertovenezia.it

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Robert Budde

Robert Budde is a commercial lawyer working in Germany (Cologne) as a partner of the law firm CMS, advising companies on their agency and distribution arrangements as well as on related German and EU competition

law issues. Robert's practice furthermore includes assisting his clients on all contract law issues related to procurement, production and distribution. In case of dispute, he represents his clients in court, often in an international context.

robert.budde@cms-hs.com

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María Domínguez Delgado

Maria Dominguez is a corporate lawyer registered in the bar of Barcelona.

She is specialized in corporate and restructuring transactions, both national and cross border and in international contracts (amongst are agency, distribution, franchise contracts).

She has acquired international experience in the United Kingdom (London), providing corporate and contractual advice for all types of operations in Spanish and English Law to international companies seeking to expand their business in the United Kingdom and Spain.

She has also experience in advising national and international companies in all kinds of issues in the field of Intellectual Property (trademarks, designs, unfair competition and advertising, as well as civil and commercial conflict resolutions).

Rocco Franco

Rocco Franco qualified as an Avvocato in 1992 and as a Solicitor in 1994. He has practised law for most of his professional career in the City of London.

He has an extensive experience of setting-up business operations and advising clients on international acquisitions, intellectual property and IT rights and inward real estate investments in the UK. His work has a particular emphasis on cross border aspects of transactions, contracts, companies, trusts, litigation and regulatory issues.

Rocco acts for individuals, institutional clients and many well known Italian and English businesses of different sectors including design houses, fashion retail, logistics, engineering and banking. He advises a number of Italian institutions and Industrial Associations and their members on substantive and procedural aspects of English law.

He frequently lectures and writes articles on commercial legal topics for various publications.

Pini Franco LLP
22-24 Ely Place
London EC1N 6TE

rfranco@pinifranco.com
www.pinifranco.com

Anna Gibello

Anna Gibello is a lawyer working in Belgium (Brussels) as a partner of the law firm FLINN. Anna Gibello has gained broad experience in commercial law, international contract law, fair trade practices and dispute resolution (in particular in the food, textile and mechanical sectors). She advises clients in negotiating and drafting their commercial contracts, as well as restructuring their distribution networks. She also represents them in legal disputes before the Belgian courts regarding civil and commercial issues.

anna.gibello@flinn.law

Fernando Sales Bellido

Fernando Sales is a lawyer in the Barcelona office of Fabregat Perulles Sales Abogados.

He is co-founding partner of the firm, having previously worked as a lawyer for relevant local law firms. Fernando also gained a significant experience in the international field through having spent time working in offices in the United Kingdom and France with whom he continues to maintain a working relation.

He heads the firm's Litigation and Arbitration and dispute resolution areas.

His professional practice covers a wide range of corporate and commercial litigation and arbitration national and international, and advising on commercial areas as, among others, distribution and agency contracts, unfair competition and real state. Fernando is MCIArb accredited arbitrator.

f.sales@fabregat-perulles-sales.com

Hans Urlus

Hans Urlus, member of the Dutch Bar Association, is partner of the law firm Greenberg Traurig and works in the Amsterdam office. Hans coordinates inbound and outbound investments with respect to China and counsels international clients in all aspects of international trade, commercial agency, franchise and distribution, with a focus on EU and national competition law, EU regulatory issues, mergers and acquisitions.

He is also involved in litigation and arbitration in relation to these matters. Hans has worked in the regulatory field, including numerous cases

involving the introduction of various regulated products into the EU market, and heads the German desk of the firm's Amsterdam office.

urlush@gtlaw.com

Josef Wolff

Dr. Josef Wolff is Rechtsanwalt (lawyer), registered at the bar of Salzburg, Austria since 2011. He works as partner of the family law firm "Wolff, Wolff & Wolff" in its offices in Milan, Salzburg and Vienna. The law firm is an established family law firm having provided assistance in Salzburg over various generations since 1911.

Dr. Josef Wolff is specialized in legal consultancy regarding cross border issues Austria-Italy, particularly within commercial law, litigation, trust law and laws of succession.

He has an interest in legal doctrine, having achieved a doctorate in international private law with a publication on trust law in Austria, UK and Roman Law.

josef.wolff@wwwolff.at

ISBN 978-88-14-22852-0

023100373