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SUSTAINABLE ECONOMY ACT

REGULATIONS GOVERNING DISTRIBUTION AGREEMENTS FOR AUTOMOBILES AND INDUSTRIAL VEHICLES

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At the last minute a surprising legal reform was made to the Agency Law (AL), taking advantage of the totum convolutuum that has surrounded the drafting of the Sustainable Economy Act (Ley de Economía Sostenible). It is an example of how far lobbying has come in our country and what little criteria is to be found in our political parties, with regard to such a sensitive subject. By now, the reform that was achieved in the Sustainable Economy Act (SEA) by the 16th Additional Provision (AP), with regard to the regime governing distribution agreements, will be common knowledge. It is, therefore, advisable that this Note analyse its contents in more detail than by giving just a simple synopsis of the new regulations.

1. Description of the Legal Reform

The Law extends the legal regime governing agency agreements to the distribution agreements of the automobile and industrial vehicle sector. Strictly speaking there is no real extension of the AL regime, but rather the creation of specific regulations, which will be compulsory, for such distribution agreements; in other words, they cannot be modified by an agreement between the manufacturer/importer and the distributor. Any clause whereby the supplier reserves the right to unilaterally amend the essential (?) contents of these agreements is declared invalid, "in particular, the entire range of products and contractual services, the dealer's business plan, the investments and amortisation period, the fixed and variable remuneration, the product and service prices, the general sale and after-sale conditions, the commercial guidelines and the distributor selection criteria". The law, whose wording leaves a lot to be desired, stipulates that the distributor "shall only be obliged to make those specific investments that are necessary to execute the agreement and which are expressly and individually stated therein or in its amendments. Said investments shall only be made when a period has been established for each of them, wherein it is deemed that they will be amortised". Specific investments are considered to be those that cannot effectively be used for other purposes.

When the distributor is "obliged to make a minimum purchase to have a certain stock available based upon its sales objectives", he will be entitled to return the un-sold products within sixty days of their purchase, and the supplier will be obliged to buy them back.

When the agreement is terminated "for any cause whatsoever", the distributor will receive a compensation that will be equal to the amount of the specific investments that have not yet been amortised. He will also be entitled to receive compensation for clientele in terms similar to those provided for under Article 28 of the AL, albeit substituting the average annual amount of agency commissions with the average annual amount of the sales made by the supplier to the distributor. The supplier will reimburse the distributor for any "employee compensation" paid for lay offs resulting from the agreement's termination or for "any type of contractual termination". The supplier will acquire any goods that are in the distributor's possession, at the price used

when they were sold to the distributor. The aforementioned compensations are established "without prejudice" to any potential compensation for contractual breach and "any clause stipulating otherwise would be null and void".

The supplier may not object to the total or partial assignment of the agreement, if the assignee company undertakes in writing to maintain the organisation, structure and resources of the assignor.

Any legal actions that arise from this agreement will be tried by the judge that corresponds to the distributor's registered offices and "any clause stipulating otherwise would be null and void".

The Senate passed, but Congress finally rejected, the rule for transitional law, whereby "the precepts of this law" would be applicable to any distribution agreements entered into prior to the date this law entered into force.

2. Analysis

However, this law is not applicable to distribution agreements!

The anger expressed recently by manufacturers and importers of automobiles and industrial vehicles is unwarranted. In the 16th AP of the SEA, it is stated that the new regime is applicable to any party that "promotes" commercial transactions "for and on behalf of its manufacturer/importer", "in exchange for remuneration". However, the distributor/dealer in our markets does not actually receive "remuneration"; it obtains income from the final resale of the products, and it obviously does not sell such products for and on behalf of the manufacturer/importer, but for and on its own behalf (it is not a commission agent). In short, this coarse legal reform has failed to achieve its objective, because it would in fact only be applicable to commercial agents (and not to all of them). It would only be applicable to agents who "assume the risk and responsibility" involved in the transaction. That is to say, any agent who has agreed to guarantee the transaction according to procedures and limitations established under Article 19 of the AL. In other words, practically no-one.

We are well aware that, on occasions, a distributor may have the vehicles on deposit, or similar arrangements, without actually acquiring title to them and that the final agreement is executed in the manufacturer's or importer's name. However, it would also be absurd if the new regulations were only applicable to these distributors, because the supplier could then get around the law by simply forcing the distributor to sell in its own name. Moreover, the distributor-agent profile does not make sense with the regime for repurchases (buy-back), stocks and forbidden clauses that are set forth in the successive sections of the 16th AP of the SEA, which presupposes that the distributor assumes the risks that are inherent in ownership and final sale.

Given that this conclusion, which is indisputable, leads to an absurd legal scenario, it is most likely that every opportunity will be seized to totally run over the text that was enacted and bring about a legal "re-classification" of the case, via a corrective procedure for misprints or typographical errors. Therefore we will pay little heed to this objection. Only if one assumes that said correction could at some time occur, would it make sense to continue with this line of reasoning, as we do below.

"Applicability" of the Agency Law

The 16th AP of the SEA extends the applicability of the AL to such distribution agreements. We assume that the entire Law will be applicable since, irrespective of the fact that the regulations subsequently contained in the 16th AP differ from the AL, it does

not state that the AL is applicable with the exceptions provided for under the 16th AP. Furthermore, it would be impossible to apply the 16th AP in conjunction with the rules of the AL, being that the latter contradicts said AP. Therefore, the AL must be understood to be supplementarily applicable.

In substance, the only precepts of the AL that can be considered to extend to distributors are those set forth under Article 7 (distributor's exclusivity obligation!), Articles 20-21 (non- competition clauses and their limitations in time), Articles 23, 24, 25, 26 (term, termination and prior notice) and Article 31 (the statute of limitations for claiming clientele-related compensations, non-amortised investments and damages).

"Until a law is passed"

The 16th AP of the SEA is presented as a transitory regime, until a specific law on distribution agreements is passed. It is correct to say that the General Commission for Legal Code has been working on a law of this type for some time. However, for those who are familiar with the enduring nature that "provisional" laws have always had in Spain, it would not be surprising if the law that they were working on never sees the light of day. No Government would venture to enact a law that would negate the social triumph that the 16th AP of the SEA represents for distributors, as can be seen in past examples of regimes involving contractual protectionism. This law will endure; to such an extent that we can only expect to see some type of revised version of Law 12/1992, to avoid perpetuating the sticky situation whereby Spanish distributors of a third-party's goods are awarded a more advantageous legal position than that granted to commercial agents.

Unilateral amendment of an agreement's essential contents

Any clause that allows the manufacturer/importer to change the essential conditions of the agreement, such as those that are listed in the Law (albeit not specifically), will be null and void. For the same reason, we understand that any clause that causes an early termination of the agreement if the distributor disagrees with the changes proposed by the supplier, must necessarily be considered null and void. Furthermore, in such cases, what the Law does is to create a powerful incentive so that manufacturers/importers enter into agreements with a specific term, which will be short enough for the relevant commercial conditions to be amended at a later renewal (at least whilst there is no risk of having to pay the costly compensation for termination provided in the new law). In addition, incentives have been created that encourage manufacturers/importers to force contractual abandonment in agreements that have an indefinite term. Moreover the law will cause (and not prevent) new conflicts, sacrificing legal certainty by using the term "essential", which will have to be defined on a case-by-case basis in a system which makes it necessary to litigate. Finally, it is difficult to understand why the supplier cannot unilaterally establish the "distributor selection criteria". By definition, a distributor candidate (or a candidate to have the existing agreement renewed) should have no legitimate claim to jointly act with the supplier in order to establish the conditions under which the selection will be carried out. Perhaps the Law is referring to the contractual assignee that is mentioned under Section 7, and, therefore, the prohibition would consist of the manufacturer/importer's not being entitled to pre-define the distributor profile so that the current distributor could not effectively assign the agreement.

Specific investments

The defective Section 4 of the 16th AP of the SEA seems to make the distributor's duty to carry out "specific investments" dependent upon two concurrent conditions. The

first of which being that said investments must have been conventionally, individually and expressly agreed. The second of which consists of it being necessary to establish a term for each of them that "is considered" necessary for their full amortisation. If no term is included in the agreement, the distributor will be exonerated from making such investments, even if the distributor may have made a firm commitment to finance them.

What happens if the forecasted amortisation is incorrect? One cannot just state, ex post, that the distributor should not have made the investments, because they have already been made. It is logical to think, therefore, that they would be compensated according to that set forth under Section 6 (a) herein, if the investment was still not fully amortised at the time the agreement is terminated for whatever reason. But should it also apply if the erroneous forecast were attributable to the distributor, thus obliging the manufacturer/importer to assume the former's possible mistakes, even if the agreement were terminated within the agreed-upon term? The whole idea makes no sense. It should be kept in mind that in the case of agency agreements this compensation is only applicable to agreements with no defined term, and only if the agreement was terminated for a reason that was not attributable to a breach on the part of the agent.

However, a more common situation would be a correct investment "forecast", with an extraordinary termination of the agreement, due to a breach on the part of the distributor. Does this situation merit compensation? According to the SEA it does, because the indemnification in question is due no matter what the reason was for terminating the agreement.

What happens if the distributor makes specific "improper" investments? For example, because they were suggested by the manufacturer/importer or because they were accepted by the distributor, without meeting the requirements set forth under Section 4, or because the distributor himself does not consider the investments to be specific but then it turns turn out that they are (perhaps because the company that occasionally competed with the manufacturer went bankrupt or because it was merged with the latter).

Return of stock

Pursuant to Section 5 of the 16th AP of the SEA, the obligation to buy back the products arises when the manufacturer/importer requires that the distributor make a "minimum purchase in order to have a stock on hand, according to the sales objectives". Consequently, the obligation to buy back the inventory would not be appropriate if the minimum purchase were made for some other purpose than that of stocking up; for instance, if it were made so that the manufacturer could make minimum annual investments or so that the distributor undertook to perform optimally.

Those products that were supplied but "not ordered by customers" may be returned by the distributor. Therefore, any products that were sold and recovered due to default by the customer (exercising the reserved ownership or a condition subsequent) may not be returned. When there is a right to return the products, the manufacturer or importer must "repurchase" them, that is, buy them back. The legal procedure to do so is not thoroughly refined, because the Law assumes that return requires that a bilateral sale and purchase arrangement exists, which would require another agreement by the parties, albeit compulsory. What would have made sense, according to the interests that this Law protects, would have been to grant the distributor a right of re-sale, which could be carried out by means of a simple notice.

The risk existing in the interim of time falls on the distributor. If the products are not

returned in the same conditions under which they were supplied, the manufacturer/importer is not obliged to accept the relevant return.

Compensation for clientele

The compensation for clientele set forth under Section 6 (b) of the 16th AP of the SEA settles years of debate, legal battles and interpretation disputes with regard to whether the distributor has a right to the compensation that is established under Article 28 of the AL. But the lucky distributor that is regulated under the SEA is even more fortunate than simple agents; such simplistic analogy now falls short.

The agent regulated under the AL has a right to this compensation only "when it has contributed new customers to the business or it has significantly increased its transactions with the previously existing clientele" or when its prior business activity could continue producing "substantial" advantages for the business/entrepreneur. For the distributors regulated by the SEA, such conditions are not established. But it is clear that they should be applicable to them because the compensation for clientele is only justified by any (future) income that the distributor produces for the manufacturer/importer and for which they are not compensated in the agreement. If the clientele is linked to the brand name (which is likely in the automobile sector), the creation or increase of clientele will be attributable to the manufacturer's brand name and not to the performance of the distributor. Therefore, I suggest we continue to concentrate on the analogy of the AL, even if now it is in *malam partem* for the distributor.

In addition, the third restriction that is established under Article 28.1 of the AL, namely, that the compensation must "be fair" because clauses exist that limit compensation for the (sales) that may be lost or for any other circumstances that arise.

The excesses included by this "clandestine" legislator do not stop here. The compensation for clientele, in the case of agents, "cannot, under any circumstances, surpass" the agent's average annual income over the past five years. However, the compensation for the distributor under the SEA may "under no circumstances be less" than the amount established. That is, what would be a maximum or cap in the case of agents, would be the rule, in the case at hand. The basis for its calculation, which in this case cannot be the commissions, will now be the average annual sales made by the supplier over the past five years. That is to say, it is based not even on the distributor's "margin" but upon the gross amount collected by the manufacturer/importer, which is simply absurd.

Finally, and what is worse, is that the compensation for clientele is a right for the distributor that is established regardless of any breach on the part of the latter because, in contrast to the situation with agents, the concept of compensation is maintained, even if the contract is terminated by the manufacturer/importer or because of a breach by the distributor.

Other compensations

The SEA confers compensation rights upon the distributors that were not even imaginable for the agents "protected" by Law 12/1992. In addition to the compensations that we have already analysed, the distributor is also entitled to receive compensation for the indemnifications it has to pay for any employees who are laid off due to the termination of the agreement, and for the repurchase price of any goods that are in stock.

These provisions are incredibly far-fetched. It is hard to believe that the SEA is forcing the manufacturer/importer to pay a compensation to the distributor for the costs

the latter suffers in firing its personnel, even if the agreement were terminated due to the ordinary expiration of its term or because the distributor may have abandoned or breached the agreement or because it may have fallen into bankruptcy or receivership. With regard to buying back the stock, a situation may also arise, as stated above, where the agreement is terminated due to reasons that are not related to wills of the parties or the criteria of the supplier, but rather which are due to the fact that the goods are no longer in the same condition as when they were acquired, or because they were acquired without the supplier having imposed an obligation to keep a minimum stock. Since everything in this Law is compulsory, the manufacturer/importer cannot escape this duty by granting the outgoing distributor a supplementary term that is long enough to liquidate its stock.

The four types of compensation established under Section 6 are compatible ("without prejudice to") the compensations established by common law in cases of any contractual breach by the parties, which renders any clause otherwise null and void. This is to say, any clause that limits the compensations of the distributor, as set forth above, will not be valid if the breach is attributable to the supplier. Any clause that limits the amount of the compensation to be paid or that excludes certain types of damages, such as incidental damages or lost profit (Lucrum cessans), will not be valid (?) either. I imagine that the inclusion of any penalty clauses would also be suspect, particularly those made in favour of the supplier.

Contractual assignment

Section 7 of the 16th AP of the SEA considers good will as a right that can be included as part of the distributor's property; which, accordingly, can be transferred without the supplier's consent, and allows the distributor to keep any capital gains. This option is not criticisable in itself but the solution is not as transparent as the legislator would have supposed. The supplier cannot avoid good will from being transferred, but it can work out an agreement whereby the assigner continues to be obliged by any past debt, and perhaps future debts, if it turns out that the supplier is obliged to put up with the assignee and cannot refuse to accept the latter based on the simple grounds of comparative solvency.

"The supplier may not refuse its consent" are the words set forth by the legislator, wording which has been taken from the usual international agreements. The phrase, however, is misguided. The supplier is not obliged to consent, but it is simply subject to the assignment, whether it likes it or not. The supplier may object to the assignment if the latter does not comply with the requirements established and it will then be necessary to either bring it to court or settle. However, the relevant judgement or award dismissing the case is not going to force the supplier to issue a statement of will; what is going to happen is that the assignment will be condoned.

Judicial authority and governing law

For the purposes herein, the rules regarding exclusive judicial authority that are established by the AL are repeated. And, in like manner, the interpretative problems related thereto. Will arbitration be possible instead of court proceedings? Can the contracting parties subject their agreement to foreign law? Obviously, the answer to both these questions is yes, being that the SEA cannot repeal the commitments that Spain holds in these matters, which are established under the Rome Regulations I of the EU. The possible choice of a foreign law, (as encouraged by the SEA and which cannot be avoided), generates uncertainty of all types with regard to whether the relevant competent Spanish judge will enforce a certain legal regime as a kind of mandatory law or as a precept of public order in its jurisdiction. I leave that question in the air. Will the law governing exclusive authority be applicable when it turns out that it

is the competence of a foreign judge, according to some of the criteria set forth under Regulations 44/2001? Clearly not, since the national laws cannot repeal the jurisdictions, even facultative jurisdictions, that are set out in community law (see Supreme Court Judgement of 15 November 2010, regarding an agency agreement).

The prognosis is evident: manufacturers and importers will want to make their agreements subject to foreign law and they will submit all future litigation to commercial arbitration or to the relevant foreign jurisdiction. Nevertheless, this will not do away with the uncertainties.

Other distribution agreements

The 16th AP of the SEA is only applicable to distribution agreements for automobiles and industrial vehicles. However, whoever is familiar with the judicial experience that came about with the enactment of the AL in 1992 knows very well how perverse the results can be if similar laws are passed without thinking. If, at the date hereof, our civil case law has not yet managed to escape from the shadow that an analogous application of the AL had on distribution agreements, one can rest assured that this new law will be applied similarly to all the other distribution agreements that are different from those set forth under the 16th AP of the SEA. However, judges will not have to go as far to reach the old distribution agreements from this law, as they had to go from the Agency Law to reach the commercial distribution agreements prior thereto. It is not necessary to highlight how significantly this deplorable, nocturnal and clandestine legislative creation of the Spanish Senate is going to have on our legal system.

Transitory issues

The Congress did not allow the new regime to be applied to the existing distribution agreements. But will that actually be the case?

What happened was that the Congress rejected the Amendment proposed by the Senate whereby this Law would be applied to distribution agreements that were executed prior to the date the SEA came into force. However, this does not imply that the new law is not retroactively effective, but simply that it exclusively applies the general rules of transitory law. I highlight the fact that the dilemma is based on the old-time diversity of principals that governed Transitory Provisions 1 and 4 of the Civil Code, which is made manifest in situations of transition involving distribution contracts and hierarchical relations of an ongoing nature. This question is sufficiently cumbersome and serious for it to be left unresolved – for the time being.