Penalty for lawful withdrawal from a contract

(Supreme Court [Civil Division, First Chamber] Judgment no. 1471/2024 of 6 November)

The question is whether a 'penalty' price can be put on the exercise of the right to withdraw from a permanent continuing bilateral contract.

ÁNGEL CARRASCO PERERA
Professor of Civil Law, University of Castilla-La Mancha
Academic Counsel, Gómez-Acebo & Pombo

1. The judgement

A distribution contract between Cafento Coffee Factory S.L. ('Cafento') and Perymuz was signed on 9 June 2014 for the distribution by Perymuz, in the province of Malaga, of Cafento's own products and others marketed by the latter. For the purposes of the litigation, the following stipulations of the contract are of interest:

— Clauses 15.1 and 15.2 indicated that the contract was without term, permanent, but either party could terminate it with three months' notice.

— Clause 17.1 established that the termination of the contract due to the distributor's unilateral withdrawal or resiling would give rise to the payment of compensation to Cafento, the amount of which would be equal to the net turnover between the parties in the immediately preceding two years.

— Perymuz notified Cafento of its withdrawal from the contract on 2 December 2016.

— In response, Cafento filed a claim against Perymuz in which it requested the court to declare the contract resiled by unilateral withdrawal, as well as the non-payment of certain invoices, and that the defendant be ordered to pay the claimant 632,286.25 euros as compensation for the withdrawal.

— The Tenth Chamber of the Madrid Provincial Court substantially acknowledged Cafento's claim.

— Perymuz lodged an appeal in cassation.

In the first ground of appeal, Perymuz claimed an infringement of Article 1152 of the Civil Code and the case law on restrictive interpretations of penalty clauses. The appellant argued that compensation provided for in the contract in the event of unilateral withdrawal cannot be legally considered a penalty. The Supreme Court recalls that contractual practice uses different provisions in the event of unilateral termination of contract, including both the right of withdrawal and the penalty clause, which, although not completely the same, are related legal concepts. On the one hand, the unilateral withdrawal clause entitles the party exercising it to terminate the contract in exchange for the fulfilment of a monetary obligation and, on the other hand, the penalty clause is also a monetary obligation, but of an ancillary nature, which, in accordance with Article 1152 of the Civil Code, serves to predetermine the consequences of the breach of a main obligation by setting a penalty of a compensatory nature. The Supreme Court cites Judgment no. 612/2000, of 20 June, which refers to this distinction. The Supreme Court concludes that this distinction works against what the appellant claims, since, although according to both courts a quo the agreed compensation must be paid, the penalty clause can be adjusted or revised by the court if the legal provisions set out in Articles 1152 and 1154 of the Civil Code apply, while the monetary obligation of the right of withdrawal cannot be adjusted or revised as it is not strictly an event of contractual liability as there has been no breach in the strict sense, but rather such a monetary obligation would be the price of unilateral withdrawal. Likewise, it declares that the Supreme Court's case law has admitted that a penalty clause can be agreed as a means of facilitating withdrawal, based on Articles 1152 and 1153 of the Civil Code (Judgments no. 615/2012, of 23 October, and no. 530/2016, of 13 September, and judgments cited therein). In view of the above, the Supreme Court rejected the first ground of appeal, concluding that there was no infringement of Article 1152 of the Civil Code and that the clause linking the distributor's unilateral termination of the contract to the payment of compensation should not be inapplicable.

In the second ground of appeal, Perymuz claims an infringement of Article 25 of the Agency Contract Act and the case law on the prohibition of perpetual relationships in permanent contracts. The appellant considers Article 25 to be applicable by analogy to the distribution contract, in the sense that conditions for withdrawal cannot be imposed where so onerous and disproportionate that they, in fact, prevent any withdrawal. Citing Judgment No. 173/1986, of 14 March, the Supreme Court declares that a permanent contract should not be confused with one with a perpetual relationship, and even less so if there are provisions in the contract itself to terminate it, as is the case here. In the present case, the parties agreed on a permanent contract clause, but, at the same time, they included in the same clause the possibility of termination with three months' notice, and, in the event that the distributor decided to unilaterally terminate the contract, the compensation clause. Given that the parties are sellers and not consumers, the court considers that there is no imbalance or disproportion.

2. Commentary

Greater familiarity with the facts will surely lead to the conclusion that the Supreme Court's ruling is in line with what is just in the case, which is not questioned here. But the fundamental arguments for rejecting the appeal are questionable, due to their paradoxical nature.

It is true that the appellant was not very clear about what he was asking for when he raised the first ground of appeal. In any case, the Supreme Court implicitly agrees with him, since compensation for lawful early withdrawal is not the same as a penalty clause for breach of the duty of permanence or for early termination of the contract. The *amount for lawful withdrawal* is a price paid to buy a withdrawal that would not otherwise have lied with the distributor. The *penalty clause* is (fixed) compensation for non-compliance. However, if the distribution contract were permanent, it would not be possible to link a penalty clause to the withdrawal, which is in any case lawful. Of course, if the withdrawal cannot be penalised, it is also not admissible for the distributor to have to 'buy it' because of a penalty, since the right to withdraw is already part of his estate. The only thing that would be possible, in the best of cases, would be a penalty for failure to comply with the notice period.

Consequently, the price or penalty (whatever you want to call it) was without reason and did not bind the distributor. Therefore, the Supreme Court Judgment no. 612/2000 cited is irrelevant. The following had been agreed there: 'In the event of termination of this contract by either party, the interested party shall compensate the injured party for an amount equal to ten percent of the amount delivered in this act'. But it was a sales contract, which cannot be continued (and even less so, permanent), so neither seller nor buyer had the right to withdraw already incorporated into their estates.

That is, unless it is said - and the judgement seems to imply something along these lines - that, in a case of sophisticated parties, these can agree on a price for withdrawal. For - the argument continues - what is decisive is that the withdrawal exists, so that the contract does not become a perpetual relationship. But this is also inadmissible, because the price in question again lacks reason, since the distributor 'buys' with it something that is already his. On the contrary, I believe that even in a distribution contract not subject to agency law, it is not possible to put a price on withdrawal if the agreed term is permanent. At least - to reduce the scope of my statement - when the price clause is not exquisitely symmetrical. Because, if it were symmetrical, a reciprocal penalty clause could be valid as an aleatory commutative contract, where each party makes their 'bet' of money in consideration of the correlative bet of the other and one of the two (the one who does not give up) wins the game; aleatory, yes, because, at the time of contracting, neither of the two contracting parties could anticipate which of them would be impelled to pull out of the contract before the other party.

Of course, it may seem that the whole thing is pointless because, if the licensor cannot charge for the other party's withdrawal, he could well compensate for this loss by charging higher royalties. But it is not the same thing: charging more royalties to offset other amounts is an obligation that has a reason; charging this same amount for withdrawal is without reason.

Finally, another paradox worthy of reflection: according to the Supreme Court, penalty clauses can be adjusted in principle (although in practice they are never adjusted by the courts), but 'prices to withdraw' (once again, the penalty for withdrawal) are not included in the scope of Article 1154 of the Civil Code. In other words, if the clause is a penalty for non-compliance, it can be adjusted; if it is a price and there is no non-compliance, the amount cannot be adjusted. That is to say, the person who fails to fulfil their obligation is in a better starting position than the person who goes to the market to buy his release.