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Commercial Agency Law in the European Community for the United States Principal

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COMMERCIAL AGENCY LAW IN THE EUROPEAN COMMUNITY FOR THE UNITED STATES PRINCIPAL

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I. INTRODUCTION

In an era marked by the expansion of international trade opportunities for U.S. firms, American lawyers must increasingly familiarize themselves with international and foreign national law. The interaction between U.S. and foreign economies has had a serious impact on civil litigation. Whether in U.S. or foreign courts, American commercial enterprises are now much more likely to be engaged in antitrust litigation or contractual disputes. This paper will focus on a major area of this emerging body of international civil law by examining the European Community's law on agency.[1] First, this paper will review agency contracts and European competition law. An analysis of the principal/agent relationship itself will follow, focusing on:

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1. "Agency is a difficult topic in Community law and is the source of great danger to businessmen who are cross-trading in Western Europe." Neville March Hunnings, Ph.D., *Agency and Jurisdiction in the EEC Conflict of Laws*, J. BUS. L. 244 (1982).

(1) the principal's rights and duties;
(2) the commercial agent's rights and duties;
(3) remuneration; and
(4) termination of agency.

When dealing with a member state of the European Community [hereinafter EC], the U.S. lawyer must be aware of both EC Law and the national law of the member state involved. Due to legal principles and social attitudes, agents' legal protection still varies widely from country to country.[2] Lawyers, therefore, must be careful not only in drawing up the commercial terms of agency contracts, but must also pay special attention to which law will apply and to which courts will have jurisdiction.[3] The EC has recently adopted a directive designed to harmonize these laws by January 1, 1994.[4] Besides this directive, which will be examined in more detail later in this paper, EC law principally affects commercial agency agreements through Article 85 of the European Economic Community Treaty.[5]

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2. For example, Germany and France have very detailed statutes relating to the agency relationship while the United Kingdom and Ireland have almost no statutory provisions regarding agency. Elizabeth Thuesen, *Approximation of Agency Law and the Proposed EEC Directive on the law Relating to Commercial Agents,* 6 EUR. L. REV. 427, 429-430 n.6 (1981).

3. Hunnings, *supra* note 1, at 244.

4. Council Directive 86/653/EEC of 18 December 1986 on the Coordination of the Laws of the Member States Relating to Self-Employed Commercial Agents, 1986 O.J. (L382) 17 [hereinafter "Directive"].

5. Article 85(1) sets forth specific competition rules for the Community:

> 1. The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction

II. ARTICLE 85 AND AGENCY

Although the substantive Treaty competition rules are contained in Articles 85 and 86, legal practice in the EC demonstrates that Article 85 is more important for commercial agency agreements.[6] Article 85(1) prohibits agreements between undertakings if they restrict competition within the common market or affect trade among the member states. The Commission and the Court have interpreted the word agreement broadly to include all legally binding arrangements, whether they are written, oral, or inferred from the circumstances.[7] The legal practitioner should be

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> or distortion of competition within the common market, and in particular those which:
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> (a) directly or indirectly fix purchases or selling prices or any other trading conditions;
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> (b) limit or control production, markets, technical development, or investment;
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> (c) share markets or sources of supply;
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> (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
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> (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contract.

Treaty Establishing the European Economic Community [hereinafter Treaty of Rome], Mar. 25, 1957, art. 85(1), 294 O.N.T.S. 2 [hereinafter EEC Treaty].

6. Jaap Feenstra, *Distribution and Commercial Agency and EEC Law, in* COMMERCIAL AGENCY AND DISTRIBUTION AGREEMENTS: LAW AND PRACTICE IN THE MEMBER STATES OF THE EUROPEAN COMMUNITY AND THE EUROPEAN FREE TRADE ASSOCIATION 3-4 (ASSOCIATION INTERNATIONALE DES JEUNES AVOCATS gen. ed., 2d ed. 1993).

7. "An exchange of letters may constitute an agreement within the meaning of Article 85(1)." *Supra* note 6, at 5.

careful of this possible problem area.

Although Article 85(1) principally intended to cover horizontal arrangements such as cartels, the Court of Justice extended its applicability to vertical arrangements as well.[8] Vertical arrangements involve the distribution of a single producer's product. Restraints can be imposed anywhere in the production or distribution pipeline. Commercial agency agreements can create such vertical restraints if they restrict the freedom of action of one of the parties toward a third.

According to Article 85(2) of the EEC Treaty, "any agreements or decisions prohibited pursuant to this Article shall be automatically void." The Commission has the power to void entire agreements, if the unacceptable passage is completely integrated, or the Commission can void only those parts of the agreements that violate Article 85(1), if such passages can be deleted to remove unacceptable restraints.[9]

Exemptions to Article 85(1), however, are available through Article 85(3).[10] These exemptions promote economic growth

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8. Joined Cases 56 and 58/64, Consten and Grundig v. Commission, 1966 E.C.R. 299.

9. *Id.*

10. Article 85(3) declares: The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

> ◦ any agreement or category of agreements between undertakings;
> ◦ any decision or category of decisions by associations of undertakings;
> ◦ any concerted practice or category of concerted practices;

which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

> (a) impose on the undertakings concerned restrictions

and/or provide benefits to consumers. Although national courts can apply Article 85(1) and 85(2) in any given case, they cannot issue exemptions; these may only be issued by the Commission.[11] Indeed, the Council, by adopting Regulation 17, gave direct effect to Articles 85 and 86. Within that framework, the Commission has three options when notified of possible violations:

> (1) The Commission may give a negative clearance, i.e. the Commission certifies that an agreement does not fall within Article 85(1);
> (2) The Commission may decide that an agreement falls within Article 85(1) but can be exempted under Article 85(3);
> (3) The Commission may decide that an agreement falls within Article 85(1) and cannot be granted an exemption under Article 85(3).[12]

In addition to voiding an agreement, Regulation 17 authorizes the Commission to impose fines between 1,000 ECU ($1,120) and 1,000,000 ECU ($1,120,000) or an amount not to exceed 10% of the turnover in the preceding business year.

U.S. practitioners, as well as business people, must be aware of EC competition law when drafting commercial agency agreements in any European Community member state. Otherwise they may become involved in unnecessary litigation before one of the national courts, the Commission, or both.

> which are not indispensable to the attainment of these objectives;
>
> (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question. EEC Treaty, art. 85(3).

11. *See* Case 234/89, Delimitis v. Henninger Brau AG, 1991, E.C.R. 935. which applies COUNCIL REGULATION NO. 17, 1959-1962 O.J. ENGLISH SPEC. ED. 87.

12. Feenstra, *supra* note 6, at 10.

III. COMMISSION NOTICE ON AGENCY, 1962

In 1962, the Commission issued its Notice on Exclusive Agency Contracts with Commercial Agents.[13] This Notice stated the Commission's view that contracts made with commercial agents do not fall under the prohibitions of Article 85(1) so long as the agents do not engage in activities normally conducted by independent traders. The contracts, however, may specify an exclusive territory in which the agent:

> (1) negotiates transactions on behalf of the principal;
> (2) concludes transactions in the name and on behalf of the principal;
> (3) concludes transactions in his or her own name and for the principal's account.[14]

The decisive criterion for distinguishing commercial agents from independent traders is the degree of financial risk imposed on the agent. The Commission wrote in part:

> Except for the usual *del credere*[15] guarantee, a commercial agent must not by the nature of his functions assume any risk resulting from the transaction. If he does assume such risks, his function becomes economically akin to that of an independent trader and he must therefore be treated as such for the purposes of the rules of

13. Commission Notice, 1962 O.J. (L139) 2921.

14. *Id.*

15. In *del credere* agreements, the agent acts as a surety who is liable to his principal only if the purchaser defaults. BLACK'S LAW DICTIONARY 425 (6th ed. 1990).

competition.[16]

According to the Commission, an agreement purporting to create an agency relationship will fall under Article 85(1) where such an agent:

> (1) is required to maintain, at his own expense, a considerable amount of products covered by the agreement;
> (2) is required to provide, at his own expense, a considerable amount of services normally associated with independent distributors;
> (3) is authorized to determine prices or terms of business.

In such circumstances, the Commission will view the agreement as an exclusive dealing contract with an independent trader.

On the other hand, the commercial agent must be no more than an auxiliary to the business transaction "who acts on the instructions and in the interest of the enterprise on whose behalf he is operating."[17] The Commission, therefore, views such agreements as having "neither the object nor the effect of preventing, restricting or distorting competition within the Common Market."[18] The Court of Justice has confirmed the Commission's view of agency.[19] In a case involving travel agents who were required to observe tariffs set by tour operators, the Court ruled

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16. Commission Notice, *supra* note 13.

17. *Id.*

18. *Id.*

19. *See generally* Feenstra, *supra* note 6, at 12-13 (providing discussion of series of cases which parallel and confirm the Commission's view); *see also* Guy I. F. Leigh & Diana Guy, *Exclusive Agency Agreements in the EEC*, 1 EUR. L. REV. 282 (1976).

that the Notice exemption did not apply because the agent did not act as an "auxiliary organ forming an integral part of a tour operator's undertaking."[20] Given the Commission's and the Court's broad interpretation of Article 85(1) and the narrow area allowed for commercial agents, the U.S. practitioner should assure that agency agreements will pass the Court's *auxiliary organ* test.

IV. COUNCIL DIRECTIVE ON COMMERCIAL AGENTS

The Council of the European Communities adopted a Directive[21] on December 18, 1986, in order to harmonize the national laws of the member states relating to commercial agents.[22] The Council had two main objectives in issuing this Directive. The first was to prevent unequal conditions of competition by eliminating differences in law which substantially affected the conditions of competition. The second objective was

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20. The Court stated:

> [A] travel agent of the kind referred to by the national court must be regarded as an independent agent who provides services on an entirely independent basis. He sells travel organized by a large number of different tour operators and a tour operator sells travel through a very large number of agents.

Case 311/85, Vereniging Van Vlaamse Reisbureaus v. Sociale Dienst Van De Plaatselijke En Gewestlijke Overheidsdiensten, 1987 E.C.R. 3801.

21. Directive, *supra* note 4.

22. "The Directive focuses on the agent's relationship vis-a-vis the principal and concomitant issues, such as the particular duties of the principal and the agent, the agent's remuneration, terms of contract, termination, and indemnity and damage compensation." Robert D. Kullgren, Louis Lafili & Jeffrey D. Nickel, *Commercial Agency Law in Europe: Representing the Michigan Principal*, 69 MICH. B.J. 654, 654 n.7 (1990).

to safeguard or improve the protection given to commercial agents.[23]

U.S. lawyers understand the principal/agent relationship through various state statutes and court adaptations of the Restatement of the Law of Agency (Second). An agent is one who manifests consent to act in a fiduciary relationship on behalf of another and is subject to the other's control.[24] Commercial agents are divided into brokers and factors.[25] "A factor differs from a *broker* in that he is entrusted with the possession, management, and control of the goods . . . while a broker acts as a mere intermediary without control or possession of the property."[26] The primary test to determine whether the representation is one of agency or independent distributorship is whether the contracting party is acting primarily for his own benefit or for the benefit of the principal.[27]

The basic understanding of agency law is similar in civil and common law countries. The problems for U.S. principals and practitioners does not stem from differences between the civil and common law of agency, but from the source and degree of protection offered agents. U.S. contracting parties must realize that Community agents rely almost as much on civil law as on the agency contracts. In many ways, European courts afford agents almost the same protection as they give to employees in matters of termination and other contractual conditions.

The Directive defines *commercial agent* as "a self-employed intermediary who has continuing authority to negotiate the sale or the purchase of goods on behalf of another person . . . or to

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23. Thuesen, *supra* note 2, at 436.

24. RESTATEMENT (SECOND) OF AGENCY §1 (1958).

25. BLACK'S LAW DICTIONARY 59 (5th ed. 1979).

26. *Id.* at 532.

27. United States v. General Electric Co., 272 U.S. 476, 485 (1926).

negotiate and conclude such transactions . . . ."[28] The Directive explicitly excludes from this definition:

> (1) officers of a company or association;
> (2) partners who are authorized to bind a partnership; and
> (3) receivers, liquidators, and trustees in bankruptcy.[29]

In addition, unpaid agents, agents who work on commodity exchanges, and British "Crown Agents" are exempt from the Directive.[30]

According to Kullgren, et al., the first problem U.S. principals encounter is defining the type of contractual relationship they want to establish:

> A classic problem arises when, for example, a U.S.

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28. Directive, *supra* note 4, at art. 1(2).

29. Council Directive, art. 1(3) reads:

> A commercial agent shall be understood within the meaning of this Directive as not including in particular: A person who, in his capacity as an officer, is empowered to enter into commitments binding on a company or association, a partner who is lawfully authorized to enter into commitments binding on his partners, a receiver, a receiver and manager, a liquidator or a trustee in bankrupcy.

30. Council Directive, art. 2(1) reads:

> This Directive shall not apply to: Commercial agents whose activities are unpaid, commercial agents when they operate on the commdity exchanges or in the commodity market or, the body known as the Crown Agents for Overseas Governments and Administrators, as set up under the Crown Agents Act 1979 in the United Kingdom, or its subsidiaries.

> company inserts in its "distribution agreement" certain clauses which imply that the "distributor" is really an agent. When the company later wishes to terminate the contract or even let it expire, the distributor claims that he or she is an agent and as such claims certain rights of compensation and damages against the company. Another problem occurs when a company discovers that its "agent" is in fact treated as an employee of the company, subjecting the company to the host country's labor laws.[31]

Article 3 of the Directive imposes on the commercial agent a duty of loyalty, good faith, and disclosure. The Restatement likewise requires that the agent act primarily for the benefit of the principal in matters relating to the agreement.[32]

The Directive, however, limits the principal's ability to mandate covenants not to compete. In Article 20, these are called *restraint of trade clauses*. They are only valid if:

> (1) concluded in writing;
> (2) related to the geographic area or group of customers covered in the agent's agreement;
> (3) related to the goods covered by the agreement; and
> (4) are valid for no more than two years after

31. Kullgren, *supra* note 22, at 654-655.

32. *See* Restatement, *supra* note 24, at 13,387-431; *see also* Tinwood N.V. v. SunBanks, Inc., 570 So. 2d 955, 959 (Fla. Dist. Ct. App. 1990) (restitution required of agent who violates duty of loyalty); Insurance Field Servs. v. White & White Inspection & Audit Serv., 384 So. 2d 303, 307-8 (Fla. Dist. Ct. App. 1980) (showing agents' breach of duty by competing with the principal during agency relationship).

termination of the contract.[33]

Article 20(4) provides that national laws may impose other restrictions on *restraint of trade clauses* or may reduce some of the obligations.[34] In the United States, the enforceability of such covenants varies widely from state to state.[35]

Article 4 of the Directive mandates that the principal likewise must act in good faith. The duties of the principal, which he may not derogate, include providing the agent with all necessary documentation and information relating to the goods under contract. The principal must also inform the agent within a reasonable time if he anticipates a significantly lower volume of work and of his acceptance, refusal, or non-execution of business procured by the agent.[36]

In comparison, the Restatement also mandates that the principal deal fairly and in good faith with his agents. The principal must also provide the agent with information that may cause pecuniary harm to the agent or harm to the agent's reputation.[37] The EC Directive, however, restricts the principal's ability to act more so than does the Restatement and protects the agent's interests to a greater degree.

Articles 6 through 12 of the Directive define remuneration

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33. *See* Council Directive, art. 20.

34. *See* Council Directive, art. 20(4).

35. In Adler, Barish, Daniels, Levin & Creskoff v. Epstein, 393 A.2d 1175 (S. Ct. Pa. 1978), the court approved restrictions on the conduct of attorneys after they terminated their association with a law firm. Colorado, on the other hand, by statute has eliminated many covenants not to compete. COLO. REV. STAT. § 8-2-113(2) (1973).

36. The Directive does not specify what a *reasonable time* is, and the practitioner should make sure this term is defined in any agreement.

37. *See* Taylor v. Cordis Corp., 634 F. Supp. 1242 (S.D. Miss. 1986).

and commission. According to the Directive, in the absence of any agreements on remuneration and in the absence of compulsory national provisions, a commercial agent is entitled to *customarily allowed* payments. If there is no customary practice, the agent is entitled to "reasonable remuneration taking into account all the aspects of the transaction."[38]

The remuneration/commission system as defined in the Directive is fairly complicated. For this reason, it has been recommended that parties avoid the complications inherent in the Directive's system by negotiating mutually acceptable compensation plans among themselves. "Given uncertainty arising from remuneration determined in accordance with the Directive, and if the parties desire certainty, they should agree on how the agent is to be compensated. Unless specific circumstances dictate otherwise, relatively simple compensation formulas are usually best."[39]

In the absence of agreement, the Directive provides a mandatory system. If any part of the compensation varies with the number or value of business transactions, it will be treated as a commission and will be subject to Articles 7 through 12.[40]

Commissions earned during the period of the agency contract are covered by Article 7. The agent is entitled to payments for commercial transactions concluded as the result of the agent's action or with customers secured by the agent. Member States are also required to specify in their own laws that commercial agents shall be entitled to commissions on transaction generated either from the agent's specific geographical region or from a specific area or group of customers over which the agent has exclusive rights.

Article 8 relates to payments of commissions on

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38. Directive, *supra* note 4, at art. 6(1).

39. Kullgren, *supra* note 22, at 656.

40. *Id.*

transactions concluded after termination of the agency:

> (1) if the transaction is attributable to the agent's efforts during the contract period and the transaction was concluded within a reasonable time after contract termination; or
> (2) if the order met the conditions of Article 7 and reached the principal or agent before the contract was terminated.

According to Article 9, a commercial agent is not entitled to a commission if a previous commercial agent is entitled to all or part of the commission earned by virtue of provisions in Article 8. By contrast, U.S. courts will look to the contract for stipulated compensation terms upon termination of the contract. If the contract stipulates that compensation ends with termination, the court is unlikely to intervene.[41]

According to Articles 10, 11, and 12, contracting parties may not opt out of provisions which define when earned commissions become due, when commission rights expire, and when principals must provide statements of commissions due. Article 12 also requires that principals provide extracts from financials which would enable the agent to compute commissions.[42]

Whereas Article 85 of the EEC Treaty prohibited actions by contracting parties, the Directive places affirmative duties on the parties and requires certain actions from the parties and the member states. Article 13 of the Directive provides that each party has a non-deferable right to receive a signed, written copy of the

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41. *See, e.g.*, Morton v. Morton, 307 So. 2d 835 (Fla. 3d DCA 1975); Canada v. Allstate Insurance Company, 411 F.2d 5157 (5th Cir. 1969).

42. "To avoid having to disclose all of the company's sales data, some companies segregate sales data by territory or products so as to disclose to each agent only the information pertinent to that agent." Kullgren, *supra* note 22, at 656.

contract, setting out all of its terms. Member states may even require that agency contracts be in writing in order to be enforceable.[43]

According to the Restatement of Agency, each party has the power at any time to terminate the agency contract. Even language of irrevocability is usually not binding.[44] Yet, per Article 15(1), an indefinite agency contract may only be terminated by notice. The period of notice is one month for the first year, two months for the second, and at least three months for the third and subsequent years.[45] To minimize the risks of contracts of long and indefinite duration, where the agent's reliability and productivity are unknown, the principal generally should insist on a short, definite period of time for the *initial* term of the contract.[46]

Article 16, however, allows for immediate termination of the agency contract for a major breach of fiduciary duty. National law can also provide for termination "where exceptional circumstances arise."[47] Because the Directive does not define these circumstances, the commercial contract should detail with specificity the circumstances that could lead to immediate termination.

Article 17(1) requires that after termination of their agency, the member states ensure commercial agents are indemnified in accordance with paragraph 17(2) or compensated for damages in accordance with paragraph 17(3).[48] The agent is also entitled to a *goodwill* indemnity if he has brought the principal new customers

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43. Directive, *supra* note 4, at art. 13.

44. RESTATEMENT (SECOND) OF AGENCY, § 118 (1957).

45. Directive, *supra* note 4, at art. 15(2)-(4).

46. Kullgren, *supra* note 22, at 657.

47. Directive, *supra* note 4, at art. 16.

48. *Id.*

or has significantly increased volume of business with existing customers.[49] Additionally, the agent may be entitled to damages for termination. Under the Directive, damages are calculated based on the lost commissions suffered by the agent due to termination, especially if the agent has not been able to *amortize* the expenses incurred during performance of the contract; this is especially true with regard to expenses incurred on the principal's advice.[50] Indemnification and compensation, however, can only be claimed if the agent notifies the principal of the claim within one year.

V. CONCLUSION

The Directive applied to most member states as of January 1, 1990. According to Article 22(1), such provisions shall apply at least to contracts concluded after their entry into force, and they shall apply to contracts in operation by January 1, 1994 at the latest. Since the Directive was based substantially on German legislation, Germany has had the easiest time conforming its laws to the Directive. France and the Netherlands also had legislation which was easily adaptable to the Directive, whereas Belgium and Denmark had to pass new legislation in order to comply with the Directive. Italy enacted Legislative Decree No. 303 of September 10, 1991, in order to conform with the Directive. Because the Italian civil code had to be changed substantially, the Directive gave Italy until January 1, 1993, to comply and until January 1, 1994, to apply the Directive to all contracts.[51] According to Article 22(3), the common law countries of Ireland and the United Kingdom had until January 1, 1994 to conform with the Directive.

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49. *Id.* art. 17(2)(a).

50. *Id.* art. 17(3).

51. Nicoletta Contardi, *Italy*, *in* COMMERCIAL AGENCY AND DISTRIBUTION AGREEMENTS: LAW AND PRACTICE IN THE MEMBER STATES OF THE EUROPEAN COMMUNITY AND THE EUROPEAN FREE TRADE ASSOCIATION 259, 266 (ASSOCIATION INTERNATIONALE DES JEUNES AVOCATS, 2d ed. 1993).

As noted previously with regard to the United States, common law relies much more heavily on contract law and the express agency agreement itself to enumerate most of the rights and duties of the principal and commercial agent. The Directive forces both member states to codify their agency laws, making sure they do not contravene either Article 85 or the Directive.

The growth of business relationships across the Atlantic and the push for more open international markets indicates a growing requirement for awareness of European Community commercial law. When U.S. lawyers represents a U.S. principal in an EC agency relationship, they must be aware of the differences in the legal treatment of this type of agreement. The contract must be drafted not only in conformance with Community and national laws, but also in conformance with the parties' wishes.