

Indemnity Claims of Commercial Agents: A Legal Evaluation of Distribution Agreements between German and Turkish Companies

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This work analyzes the conditions of the indemnification of a commercial agent, according to German Law and Turkish Law, after a distribution agreement has ended. Germany is one of the most important trade partners of Turkey; with an average trading capacity of 15 million Euros. Products produced in Germany are often sold by commercial agents in Turkey.

The trade relationship often invokes Article 92(c) Handelsgesetzbuch (“HGB”), which constitutes a danger for indemnity claims, because 92(c) HGB allows the exclusion of indemnity claim against Non-European Member States.

Applicable Laws

The European Directive dated 18 December 1986, 86/653/EEC; The European Directive regulates the indemnity claim of a Commercial Agent as follows:

Article 7

- A commercial agent shall be entitled to commission on commercial transactions concluded during the period covered by the agency contract:
 - where the transaction has been concluded as a result of his action; or
 - where the transaction is concluded with a third party whom he has previously acquired as a customer for transactions for the same kind.
- A commercial agent shall also be entitled to commission on transactions concluded during the period covered by the agency contract:
 - either where he is entrusted with a specific geographical area or group of customers,
 - or where he has an exclusive right to a specific geographical area or group of customers, and where the transaction has been entered into with a customer belonging to

that area or group. Member state shall include in their legislation one of the possibilities referred to in the above two indents.

Article 17

- Member states shall take the measures necessary to ensure that the commercial agent is, after termination of the agency contract, indemnified in accordance with paragraph 2 or compensated for damages in accordance with paragraph 3.
- (a)The commercial agent shall be entitled to an indemnity if and to the extent that:
 - He has brought the principal new customers or has significantly increased the volume of business with existing customers and the principal continues to derive substantial benefits from the business with such customers and
 - The payment of this indemnity is equitable considering all circumstances and, in particular, the commission lost by the commercial agent on the business transacted with such customers. Member states may provide for such circumstances also to include the application or otherwise of a restraint of trade clause, within the meaning of Article 20;

(b) the amount of indemnity may not exceed a figure equivalent to an indemnity for one year calculated from the commercial agent's average annual remuneration over the preceding five years, and if the contract goes back less than five years the indemnity shall be calculated on the average for the period in question;

(c) the grant of such an indemnity shall not prevent the commercial agent from seeking damages.

- The commercial agent shall be entitled to compensation for the damage he suffers as a result of the termination of his relations with the principal. Such damage shall be deemed to occur particularly when the termination takes place in circumstances:
- depriving the commercial agent of the commission which proper performance of the agency contract would have procured him whilst providing him the principal with substantial benefits linked to the commercial agent's activities,
- and/or which have not enabled the commercial agent to amortize the costs and expenses that he had incurred for the performance of the agency contract on the principal's advice.

German Law 89(b) HGB

Implementation of the Indemnity Claim into German Law, 89(b) HGB; The EU Directive states in Article 22, that the Indemnity Claim shall be implemented under the Law of the Member States until 01 January 1990. Germany has implemented section 89(b) HGB.

Section 89 b of the HGB Reads as Follows

- After the contractual relationship has come to an end, the commercial agent may demand appropriate indemnification from the principal, if and insofar as:
- The principal derives substantial benefits after the termination of the contractual relationship, from the business connections with new customers which the commercial agent has acquired.
- Due to the termination of the contractual relationship, the commercial agent loses claims for commissions which he would have received upon continuation of the same from business

transactions, either already concluded or to be concluded in the future, with those customers which he acquired and

- After considering all the circumstances, the payment of an indemnity would conform to the principles of fairness.
- If the commercial agent has substantially increased the business connection with one customer, so that is economically comparable to the acquisition of a new customer, such will be considered tantamount to the acquisition of a new customer.
- The maximum amount of the indemnity shall be the average annual commission or other annual compensation over the past five years of the commercial agent's activity; if the contractual relationship has a shorter term, the average during the term of his activity shall control.
- This claim does not arise if the commercial agent has terminated the contractual relationship without having been given cause, therefore by the behavior of the principal. The same applies if the principal has canceled the contractual relationship, and there was an important reason for such cancellation due to the culpability of the commercial agent.
- This claim cannot be precluded in advance. It must be asserted within three months after the end of the contractual relationship.

Elements Required for an Indemnity Claim

The Agreement must be Terminated

The indemnity claim must be terminated according to Article 89(b) (1) Sentence (1) HGB. It is irrelevant how an agreement is terminated, because a distributor is always entitled to make an indemnity claim. In other words, why an agreement is terminated does not affect an indemnity claim. However, 89(b) (3) (1) provides for one exception where an indemnity claim cannot be brought, and that is when the distributor terminates the agreement on his own volition.

The Principal must Benefit

The principal must derive a substantial benefit from new customers acquired by the distributor. The new customers must have been brought by the distributor or if they already existed prior to the distribution

agreement, the principal must have had a significant relationship with them. When evaluating the benefit, it is not necessary to rely exclusively on quotas, facts, and figures.

Good Faith

Good faith is always taken into account when calculating the amount of indemnity compensation. Calculations may either reduce or increase the amount of indemnification possible and are computed according to something known as “lost profit.” The lost profit is important because it is an indicator of how much the distributor would have earned had the agreement not been terminated. The main question is: How much would the distributor earn from its new customers in the future if the relationship would still be in force?

If the distributor is guilty of breaching contractual duties, an indemnity claim may be reduced. Some factors that are evaluated when determining the amount include: financial support for marketing and advertising provided by the principal; unjust termination by the principal even though the distributor successfully and faithfully carried out its primary contractual duties.

Indemnity Claims, 89(b) (2) HGB:

According to 89(b) (2) HGB, the indemnity claim cannot exceed the annual average from royalties the distributor paid over the last five years. If the distribution agreement was in force for less than five years, the annual average of the agreement’s duration will be the amount of the indemnity claim.

The calculation of the Indemnity Claim occurs in two steps. First, a basic calculation must be made. Second, both the lost profit and indemnity claim amounts must be considered.

- Exclusion of the Indemnity Claim:

According to 89(b) (3) HGB, the Indemnity Claim may be excluded in three instances:

1. If the distributor terminates the agreement without reason;
2. If the principal terminates the agreement because of the distributor’s breach of contractual duties; or
3. If the distributors have changed

In the first instance mentioned above, it is generally irrelevant why the distributor terminates the agreement. However, there are two exceptions to this: first, if the distributor terminates the agreement due to a significant breach in contractual good faith caused by culpable behavior of the principal. This culpable behavior does not have to be *conditio sine qua non* for the termination. In other words, while evaluating the circumstances, the principal must have contributed to the termination that was declared by the distributor. For example, the reasonless payment refusal by the principal or the reasonless extraordinary termination. The second exception is disability because of disease or old age of the distributor. In such a case, the distributor would still be able to claim the indemnity, although he has terminated himself.

The most important exclusion is 89(b) (3) No. 2 HGB. It is not important why the principal has voluntarily terminated the agreement. The principal shall terminate the agreement based on important reasons that were caused by culpable behavior of the distributor. According to the EU Directive, the culpable behavior of the distributor must be *conditio sine qua non* for the declaration of the termination by the principal. Also, German judges decide in conformity with the EU Directive. An example of culpable behavior is if the distributor actively supports or enforces unfair competition, which brings the principal into danger of damages.

If the distributor is changed to another distributor, the indemnity claim is excluded, as per 89 (b) (3) No. 3 HGB. The changing of the distributor is realized through an agreement between the principal and the distributor, which cannot be made during the agreement period. A change of distributor can just be realized after termination of the agreement. This rule ensures the right to an indemnity claim for the distributor.

The Calculation of an Indemnity Claim According to German Law

Baseline Calculation – “Rohausgleich”

The baseline calculation begins with the amount of royalties the distributor received during the last 12 months of the distribution agreement. If the sales over the last 12 months of the agreement were unusually low, then the Court will omit the last 12 months from the calculation. Basically, the Court will evaluate the other years that the agreement was in force, not the unusually low sales period.

Lost Customers – “Abwanderungsquote”

The average rate of lost customers for the duration of the distribution agreement must be deducted from the baseline calculation. If the distributor never had a loss of customers, there will be no deduction.

Forecast Period – “Prognosezeitraum”

The principal must benefit from the customers acquired from distributor’s marketing efforts, even after termination of the agreement. The Forecast Period includes a timeline extrapolation of the benefit period occurring after the termination. This extrapolation and forecast period depends on the product that was sold during the agreement. In cases of long-lasting products like cars or carpets, the German courts use a forecast period of between 5-8 years.

The calculation consists of a deduction of the baseline calculation with the customer loss rate of customers. Then this rate will be multiplied with the years of forecast period.

Discounting – “Abzinsung”

Typically, an indemnity is paid to the distributor by the principal at the end of the agreed-upon time period, and this date is written in the agreement. With the Indemnity Claim, the distributor gets a one-time, lump sum payment, therefore there will be a 6% deduction taken for every year granted by the court as part of the indemnity claim. In other

words, the principal would have had to pay interest on these amounts each year, so in order to prevent a windfall for the distributor, the deduction is necessary.

Deduction because of Good Faith Reasons – “Billigkeitsgesichtspunkte”

In case of culpable breach of the distributor’s primary duties, there can be a deduction because of good faith reasons. Also, deductions can be taken if the principal invested in marketing efforts during the duration of the agreement. This amount would be deducted from the baseline amount. A judge will look at the individual circumstances of each case to determine the good faith efforts.

Limitations – “Höchstprovision”

According to 89(b) HGB, the Indemnity Claim cannot exceed a certain amount (it is capped). First, the average annual royalty amount must be calculated by taking the average of what the principal paid to the distributor over the last five years. If the agreement duration was for less than five years, then the average annual royalty amount for the entire duration of the agreement is taken. That amount must be divided by five. If the amount calculated (baseline calculation, customer loss rate, forecast period, discounting and deduction because of good faith) is higher than the cap amount, the distributor is only entitled to claim the cap amount. If the calculated baseline amount is less than the cap, then the distributor is entitled to claim just this amount.

***For Example: The distributor received 100,000.00 TL indemnity in the last 12 months:**

Customer Loss Rate: average 20 %				
1. year:	100,000.00 TL	./.	20 %	= 80,000.00 TL
2. year:	80,000.00 TL	./.	20 %	= 64,000.00 TL
3. year:	64,000.00 TL	./.	20 %	= 51,200.00 TL
4. year:	51,200.00 TL	./.	20 %	= 40,960.00 TL
5. year:	40,960.00 TL	./.	20 %	= 32,768.00 TL

Customer Loss Rate: average 20 %				
1. year:	80,000.00 TL	x	0.94340	= 75,472.00 TL
2. year:	64,000.00 TL	x	0.89000	= 56,960.00 TL
3. year:	51,200.00 TL	x	0.83962	= 42,988.54 TL
4. year:	40,960.00 TL	x	0.79209	= 32,444.01 TL
5. year:	32,768.00 TL	x	0.74726	= 24,486.22 TL

Turkish Law

Calculation Methods of Indemnity Claims in Turkish Commercial Law

Current Version of Clause 134

In Turkish Law, an Indemnity Claim is called a "Customer Damage Claim." However, an indemnity claim similar to German and EU Law does not currently exist. Clause 134 of Turkish Commercial Law reads as follows:

"a termination of agreement through one party without any reason and without any warning for a period of three months, entitles the other party to claim a damage for unfinished transactions/businesses that were begun."

According to current versions of Turkish Commercial Law, the customer damage claim arises in cases of unjust termination or unjust termination without the requisite three month termination notice. This can be contrasted with German Commercial Law, where the reason for termination of an agreement is irrelevant and does not need to be unjust.

According to EU Directive rules for Indemnity Claims, Clause 134 of Turkish Commercial Law is incomplete. Article 17 Subsection (3) of the Directive entitles a commercial agent to claim a damage amount for lost profits occurring during the forecast period. However, Turkish Commercial Law entitles a commercial agent to an indemnity claim only for business that has begun, but that has ended with the termination of the distribution agreement.

New Turkish Commercial Law and the Indemnity Claim

Beginning on July 1, 2012, the Turkish law will be changed and indemnity claims will be called: "Agency Compensating Sum." The agency compensating sum is comprised of the compensation amount for the customers that were marketed and acquired by the distributor and that were surrendered to the principal after the termination, causing the principal to continue benefiting from the new customers after termination. In this case, the commercial agent (usually the distributor) gets compensation for his lost benefits using the principles of good faith mentioned above.

Clause 122 of the New Turkish Commercial Law reads as follows:

(1) If the client (principal), after termination of Agreement

a) substantially benefits from the new customers which were marketed through the commercial agent,

b) the commercial agent loses the claim for royalty payments after the termination of the agreement, he is entitled to make a claim as though the agreement were still in force,

c) according to the individual facts of this case, the commercial agent is entitled to an appropriate claim for indemnity based on the principles of good faith.

(2) The Indemnity Claim is capped at the average annual royalty payment that the agent has received over the last 5 years of the agreement. If the agreement had been in force for a shorter period, then the average annual royalty payments of the shorter period is used.

(3) If the commercial agent terminated the agreement without any fault by the principal or if the principal terminates the agreement because of a commercial agent's breach of his primary duties, the commercial agent is not entitled to claim an indemnity payment.

(4) The Indemnity claim cannot be excluded in front of the agreement.¹ The statute of limitations for indemnity claims is one year from the time of termination.

Calculation of the Indemnity Claim According to the New Turkish Commercial Law

Clause 122 of the new Turkish Commercial Law is similar to 89(b) HGB.² In the draft of the Turkish Commercial Law, it is mentioned that the Indemnity Claim is similar to the European Directive. Therefore, the calculation of the Indemnity claim is similar to the calculation made according to German Law detailed above.³

¹ An indemnity claim cannot be excluded at the beginning of an agreement, but may be excluded once the agreement is in force, if both parties agree.

Exclusion of the Indemnity Claim through Clause 92 (c) HGB

The Conflict

Clause 92(c) HGB is a relatively new clause, which was implemented into German Commercial Law after 89(b) was implemented. It states the possibility of excluding the Indemnity Claim, when the commercial agent is doing business for the principal, and is located outside of the European Union. A major conflict currently seen over this is when exclusion is allowed in one country, but prohibited in another. The German Judiciary and case law allows such exclusion; although a third country (i.e. Turkey) prohibits it. The goal of this clause is to maintain a uniform standard and secure transactions inside the European Union.

In practice, there will be big problems in the case of a distribution agreement where the principal is in Germany and the distributor is in Turkey and German Law has been named the applicable law. In such a scenario, the German courts will decide that the Indemnity claim has been excluded (92(c) HGB), and the commercial agent would lose its claim for any compensation. In Turkey, the commercial agent would just have the possibility of recognition of such a judgment, but it would not be revised. In other words, because of the principles of full faith and credit, the Turkish Court would only revise the judgment if there was a major error in procedure, but not law.

Possible Solutions

- If you are representing a distributor or commercial agent and in a German-Turkish business relationship, it is imperative to include the new Turkish Commercial Law as applicable Law in an agreement, because the indemnity claims have the same standards and conditions as European and German Law.
- A commercial agent should always prefer to go to the Turkish Courts when they have any dispute. Even if German Law is applicable, the Turkish Courts will not exclude 92(c) HGB indemnity claims, because this would be contrary to the required conditions and prerequisites of an indemnity claim in Turkey. Article 5 of the International Private and Procedural Law in Turkey does not apply to any foreign law that comes into conflict with Turkish public order. As of now, there is no case law illustrating what will happen if Clause 92(c)HGB comes into conflict with Turkish public order or not.
- If Turkish Law is applicable and the commercial agent claims its Indemnity Compensation in Turkish Courts, the judgment would be in favor of the commercial agent. In order to execute the judgment and Indemnity Claim, the commercial agent must initiate the procedure in German Courts. The German Courts⁴ will accept the judgment on its face and only object if there is some gross breach in procedural fairness.

² Draft of Turkish Commercial Law, Number B.02.0.KKG.0.10/101-1078/4903, Clause 122 new Turkish Commercial Law, page 113.

³ Kendigelen, New Turkish Commercial Law, Page 242, 243, Domaniç/Ulusoy, Turkish Commercial Law, Page 501.

⁴ according to Article 328, 722, 723 German Code of Civil Procedure (ZPO)