

WHAT ARE THE CONSEQUENCES OF THE TERMINATION OF A DISTRIBUTION OR AGENCY AGREEMENT WITHOUT JUST CAUSE?¹

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Distribution and agency agreements, as commercial intermediation agreements, are commonly used by businessmen in order to position themselves in new markets through an independent third party (who is usually known as a distributor or agent)², who is in charge to promote and / or sell the products or services of another party (the principal) usually in a specific territory.

Does the distributor and the agent have a preferential treatment in Guatemala?

Commercial intermediation agreements are very useful, however, their termination by unilateral decision of the principal without evidencing a just cause may have unfavorable repercussions for him.

Imagine the following scenario: a foreign entity enters into a written commercial distribution agreement with a local merchant. Everything went well for ten years, but unexpectedly the distributor does not longer perform an efficient work, affecting the sales of the principal directly. May the principal terminate the contract claiming a just cause?

In most jurisdictions, there is special protection for distributors, the case of Guatemala is not the exception. In academic forums and courts, the opposition that usually exists between the principle of the autonomy of the will of the parties and the applicable

legislation that regulates mandatory compliance provisions for the relations between principal and distributor or agent has been discussed.

The Commerce Code of Guatemala provides that the only causes to terminate or rescind the distribution or agency agreements are the following:

- a) By mutual consent between the parties, expressed in writing;
- b) Due to expiration of the term;
- c) By decision of the agent, provided that he gives notice to the principal with 3 months in advance;
- d) For just cause; and
- e) By decision of the principal without just cause.

It is worth mentioning that the termination of the agreement due to the above-mentioned causes indicated in letters a), b) and c) does not generate, for any of the parties, an obligation of compensation for damages. Regarding letter d), the party who terminated or rescinded the agreement shall be responsible for the damages caused to the other party. However, in the aforementioned case, is the fact that the distributor no longer performs its work efficiently a just cause to terminate the commercial relationship? The answer would be: not necessarily.

The legislation establishes as just causes for the principal to terminate a distribution or agency agreement, the following:

- a) For breach or contravention by the distributor or the agent of the obligations that have been agreed;

¹ This article is written for illustrative purposes and is not intended as a substitute for legal advice to which clients should turn for specific cases.

² In Guatemala, the figure of the dependent agent is also regulated, he is linked to the principal by an employment relationship. This figure is not developed in this article.

- b) For the commission of an offense against the property or person of the principal;
- c) For the unfounded refusal of the agent or distributor to render the reports and accounts, or to practice the liquidations related to the business, in the time and form that has been agreed.
- d) If the agent or distributor violates a trade secret that has been entrusted to him by virtue of the corresponding agreement; and
- e) Due to the decrease in the average sales or placement of the agreed goods or services, due to negligence or ineptitude of the agent, evidenced in court.

Based on the foregoing, in the indicated hypothetical case, if the principal fails to demonstrate in a judicial process that his average sales are being affected because the distributor no longer performs his work efficiently due to negligence or ineptitude, he cannot argue this reason as a just cause to terminate the agreement. Therefore, he must assume the consequences of terminating the agreement by decision of the principal without just cause.

Which are the consequences of terminating the agency or distribution agreement without just cause?

The principal will be liable to the distributor for damages caused as a result of the termination of the agreement or business relationship without just cause. For practical purposes: How are damages calculated, when a dispute arises between the principal and the distributor or agent, when they do not agree on the amount of the compensation?

According to the applicable legislation, since one of the parties is condemned to pay compensation, the sentence (judicial process) or the award (arbitration process) may include among its resolutions the following:

- a) The damages and their amount, in accordance with the items detailed in the Commercial Code, related to the expenses paid by the distributor or agent.
- b) The damages and the amount that "in equity cor-

responds".

Thus, regarding the order to pay for damages, the court may determine the amount following the specific items indicated in the legislation. However, the problem arises in the fact that the current law does not establish parameters or items that must be considered for the determination of damages.

The applicable legislation establishes the following scenarios to determine the amount of damages, in order of preference:

- a) That the court establishes a certain amount;
- b) If the above is not possible, at least the ruling or award should indicate the basis on which the settlement should be made in a procedural issue;
- c) Ultimately, the amount will be set by an expert, applying the procedure established for expert evidence.

Consequently, although the sentence or award should ideally include the amount of damages to be paid, the tendency has been that the court does not determine them, but it is necessary to carry out an expert evidence proceeding. However, according to the current regulations, the parameter that the expert must follow is very broad: "*(...) the amount that in equity, according to the nature and circumstance of the business, corresponds*". This provision grants a high level of discretion to the expert, which may result in the violation of the rights of the principal.

What can be done to mitigate the negative consequences of terminating the agreement without just cause?

The actions to be taken will depend on each specific case. However, in general, it is recommended to include as obligations of the distributor or the agent all the possible causes for which the principal could terminate the agreement. The purpose of the foregoing is that in case of any breach of the obligations, they can be considered as a just cause to terminate the commercial relationship, without the

need to prove it judicially.

Likewise, it would be important to include a fixed amount of compensation for terminating the contract without just cause in favor of the distributor or the agent. The amount of compensation must be proportional to the role that the distributor or agent performs in favor of the principal. The foregoing, to justify to the judge or arbitrator that the parties agreed in advance and voluntarily the amount of compensation and, therefore, it is not an unfair provision. However, this criterion will be subject to the decision of the judge or the arbitrator in the specific case.

It is of utmost importance to have a distribution or agency agreement suitable to the applicable national legislation, and that foresees any controversy that may arise from it, to minimize the economic and legal risks that this type of commercial intermediation agreements may imply for the principal. At Arias, our team is formed by highly capable professionals that can give you precise advice about how to minimize the negative consequences derived from an unpredictable termination of commercial agreements, and they will gladly help you to avoid legal contingencies.



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