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AGENCY AND DISTRIBUTION AGREEMENTS (ITALY)

DS Avvocati Santa Maria Tristano Ziccardi
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Telephone:	**+ 39 02 72094019**
Fax:	**+ 39 02 72093828**
E-mail:	**mail@studiosantamaria.com**
	www.dsavocats.com

General

Agency and Distribution are entirely different types of contract under Italian (and European Union) law, where a distributor is classified as an independent contractor, not as an entity having the power to represent, and thus to bind the Company granting the Distribution; when a power to represent is vested in the agent, this is classified as a Commercial Agency, an institute specifically regulated by European Union (then, Community) directives, particularly by the Directive no. 86/653/EC, art. 1.2 of which so states "*For the purposes of this Directive, 'commercial agent' shall mean a self-employed intermediary who has continuing authority to negotiate the sale or the purchase of goods on behalf of another person, hereinafter called the 'principal', or to negotiate and conclude such transactions on behalf of and in the name of that principal*." It is worth recalling here that a European Community (now, Union) Directive is a piece of legislature mandating each Member State to conform its domestic laws to the rules set in the same Directive (whilst a European Regulation is directly enforceable in the whole terriory of the Union, as a Federal Law in the U.S.A.); all the Member States of the European Union have enacted statutes, conforming the domestic laws to Directive no. 86/653/EC.

To the contrary, "distribution agreements" are regulated by a long row of European Regulations, because they have constantly been, and still are considered material for the policy of protecting competition, as well as for the policy of protecting the free circulation of goods and services within the Territory of the Union.

The first is Regulation 19/65/EEC[1], still in force, and modified in part through Regulation 1215/99; it described the subject matter of this part of the European regulation as

[1] Which means, no. 19 of the 1965, European Economic Community, one out of the three Communities established between 1952 (European Community for Coal and Steel) and 1956 (EEC and Euratom), then merged in the European Community, then European Union.

"*categories of agreements to which only two undertakings are party and: (a) - whereby one party agrees with the other to supply only to that other certain goods for resale within a defined area of the common market*" (art. 1.1 of the 19/65 Reg.), in order to detail the classes of agrements which – while involving some form of restriction to the free circulation of goods and services in the said Territory - could be exempted from the duty to seek an individual permit by the European Commission Directorate, given their assumed little impact on the free market.

Eventually, the legislation was detailed in three "landamrk" pieces of legislation, Regulations no. 1983/83, governing the **"***exclusive distribution agreements*", no. 1984/83, governing the "*exclusive purchasing agreements*", and no. 4087/88, governing the "*franchise agreements*"; the first of them, in its art. 1, described distribution agreements as "*agreements to which only two undertakings are party and whereby one party agrees with the other to supply certain goods for resale within the whole or a defined area of the common market only to that other*". These Regulations were amended through Regulation no. 1582/97 in order to extend their expiry to December 31, 1999.

Effective January 1, 2000, the new Regulation no. 2790/99 entered into force; its subject is described as "*categories of vertical agreements and concerted practices*", and the earlier description was altered into the following : "'*exclusive supply obligation' means any direct or indirect obligation causing the supplier to sell the goods or services specified in the agreement only to one buyer inside the Community for the purposes of a specific use or for resale;*"; this Regulation will expire on May 31, 2010.

The distribution agreement is, accordingly, an entirely different way of mutually binding two business entities as the Agency; the latter is considered as a quasi-employment relationship, and the legislation, uniformed, not unified, is aimed mainly to protect the party, the agent, which appears to be ordinarily the weaker, and the protection is substantiated in granting a right to a termination bonus, which may reach even remarkably high amounts; the commercial agent has often, albeit not necessarily (the different inhabits of each member state are quite material in this), the power to bind his principal; in case of doubt, the third party frequently request to peruse the Agency agreement, which is frequently a short text, in form of a letter, and it seldom contains clauses which should remain restricted between principal and agent.

A distribution agreement, instead, is certainly not drafted for being exhibited to third parties, does not contain any power to represent and bind the grantor of the distribution, or franchise.

Freedom of Contract and Mandatory Provisions

Under Italian law, parties have freedom to agree the terms of their agency or distribution contracts; there is a general duty to negotiate terms of contracts in good faith (art. 1337, 1366 and 1375 of the Italian Civil Code [=ItCC] : contracts shall be negotiated in good faith, construed in good faith, in the sense that the construction shall be in accordance with the *bona fide* meaning of terms, and of each word, and shall be performed in good faith, in the sense that, in case of doubt, the performance must be in the form best according to – in this area – the current business practices).

In agency agreements (irrespective of whether agents are individual, partnership or a company), a termination allowance is due to the agent, provided that he is not the one terminating the relationship. A part form that, the allowance is payable to the agent regardless of whether the principal is in breach of contract or not and even if the agent has no right to damages under the general rules of the Civil Code. The allowance may take the form of a compensation or of an indemnity, but, in the absence of agreement between the parties on this point, the agent would be entitled to compensation, and not indemnity. While the indemnity alternative is capped at a sum of one year's commission based on the agent's average annual remuneration over the preceding five years (or the period of the agreement, if shorter), no maximum amount is specified for the compensation alternative.

Such rules apply, in Italy (and unlike other EU member States), to an agency for the supply of services, whilst they certainly do not apply to distribution contract, not even if a distributors serves also as an agent : in this latter case, allowances would be assessed onthe value of the goods or services sold as an agent, only.

No statutory term for giving a notice of termination exists in Italy (in case the agency or distribution agreements bear no duration clause, of course); however, a notice "at sight" or at short term, especially if after a long period of duration of the relationship, and not based on an agent's or distributor's breach of contract, might amount to a breach of an obligation to perform the contract in good faith, and consistently with the business best practice : art. 1374 and 1375 of the Italian Civil Code.

Exclusivity and Non Compete provisions

Rules on exclusivity are a crucial part of the European law on distributorship, which deserves here to be summarized.

(a) According to the quoted Regulation no 2790/1999 of 22 December 1999, art. 1(c), ""exclusive supply obligation" means any direct or indirect obligation causing the supplier to sell the goods or services specified in the agreement only to one buyer inside the Community for the purposes of a specific use or for resale;"
(b) Such exclusive obligation are valid - although not "exempted" by the European Commission's Directorate on a case by case basis - only insofar as :
    - (b.1) they bind "two or more undertakings each of which operates, for the purposes of the agreement, at a different level of the production or distribution chain, and relating to the conditions under which the parties may purchase, sell or resell certain goods or services" ("vertical agreements") [art. 2.1.], or, if the parties to the agreement are competing, only insofar as "(a) the buyer has a total annual turnover not exceeding EUR 100 million, or (b) the supplier is a manufacturer and a distributor of goods, while the buyer is a distributor not manufacturing goods competing with the contract goods, or (c) the supplier is a

provider of services at several levels of trade, while the buyer does not provide competing services at the level of trade where it purchases the contract services." [art. 2.4];

- (b.2) "the market share held by the supplier does not exceed 30 % of the relevant market on which it sells the contract goods or services." [art. 3 and art. 9 for the calculation of such a market share]
- (b.3) the agreement has not as its object "the restriction of the buyer's ability to determine its sale price, without prejudice to the possibility of the supplier's imposing a maximum sale price or recommending a sale price, provided that they do not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties [art. 4(a)]";
- (b.4) the agreeement has not as its object "the restriction of the territory into which, or of the customers to whom, the buyer may sell the contract goods or services" [art. 4(b), with four detailed exceptions].

(c.1) There is a general prohibition of clauses imposing "any direct or indirect non-compete obligation, the duration of which is indefinite or exceeds five years. A non-compete obligation which is tacitly renewable beyond a period of five years is to be deemed to have been concluded for an indefinite duration." [art. 5.a. : there is an excpetion where the buyer sells "from premises and land owned by the supplier … provided that the duration of the non-compete obligation does not exceed the period of occupancy of the premises and land by the buyer" : this comes from special rules concerning gasoline stations and beer retailers ("pubs")]

(c.2) There is a further general prohibition of clauses imposing "after termination of the agreement, not to manufacture, purchase, sell or resell goods or services", with an exception for competing goods or services offered in the premises where the buyer has operated during the contract period, and this is indispensable to protect know-how transferred by the supplier to the buyer, and provided that the duration of such non-compete obligation is limited to a period of one year after termination of the agreement [art. 5.b]. However, the contractual protection of the transferred know-how in itself may be unlimited in time.

(d) The European Commission, after an enquiry of the Directorate 4, in charge with competition matters, may withdraw the benefit of the said class exemption if a vertical agreement :

- (d.1) "nevertheless have effects which are incompatible with the [protection of free competition], and in particular where access to the relevant market or competition therein is significantly restricted by the cumulative effect of parallel networks of similar vertical restraints implemented by competing suppliers or buyers." [art. 6; art. 7 grabts a similar power to withdraw the "benefit" to Member States' authority, where such efects verify "in the territory of a Member State, or in a part thereof, which has all the characteristics of a distinct geographic market" [art. 7]; or
- (d.2) "where parallel networks of similar vertical restraints cover more than 50 % of a relevant market" [art. 8]

(e) Special rules, concerning exclusivity and further details of the reguklation, apply to :

- (e.1) "vertical agreements entered into between an association of undertakings and its members, or between such an association and its suppliers" [art. 2.2];

- (e.2) “vertical agreements containing provisions which relate to the assignment to the buyer or use by the buyer of intellectual property rights” [art. 2.3];
- (e.3) agreements “between a supplier of components and a buyer who incorporates those components” : they are not “exmpted”, and thus invaild if they limit “the supplier to selling the components as spare parts to end-users or to repairers or other service providers not entrusted by the buyer with the repair or servicing of its goods” [art. 4.e];
- (e.4) Selective distribution systems, which mean “a distribution system where the supplier undertakes to sell the contract goods or services, either directly or indirectly, only to distributors selected on the basis of specified criteria and where these distributors undertake not to sell such goods or services to unauthorised distributors” [art. 1.d : in this specific area, restrictions at the “retail level of trade” are wifely admitted, provided that however they do not create “obligation causing the members of a selective distribution system not to sell the brands of particular competing suppliers.” : art. 4.c and 5.c]
- (e.5) “Certain categories of motor vehicle distribution and servicing agreements”, under the specific Regulation no 1475/95 of 28 June 1995.

Choice of law

Parties are free to choose the system of law which is to govern their contract : this is established in art. 3 of the Rome Convention of June 19, 1980, on the law applicable to contracts, which presently binds the first 15 member states of the EU, and became a part of the general law of Italy, under art. 57 of the Reform Law on Conflicts of May 31, 1995, # 218, and which is about to be substituted by the European Regulation (thus, binding everybody in the territory of the Union) no. 593/2008 of 17 June 2008 on the law applicable to contractual obligations, nicknamed Regulation Rome I; the “Rome I“ Regulation will come into force at the very end of the year 2009. All those texts state that mandatory provisions of Italian law, insofar as qualifying as public policy rules, would override the choice of law clause.

In the absence of an express choice of law clause, the applicable law is the law with which the contract is most closely connected, which in turn is normally the law of country where is domiciled the party to the contract, whose performance is characteristic of the contract (art. 4.2. of the quoted Rome Convention, and, for the next future, art. 4.(b) and (f) of the Regulation Rome I); in the area under exam here, the law of the country where the head offices of the agent or distributor are located would govern the relationship, as expressly provided by the new rules.

Competition law issues (see also page 16 of Tunis presentation)

The principal piece of legislation is the Public Law of 10 octobre 1990, no. 287, which is totally consistent with the principles of the European Union competition law.

Following recent reform of EC law in this area, agency or distribution contracts raise fewer competition issues than was previously the case. Under the competition rules, provided certain conditions are met (such as the supplier's market share is below 30%), most distribution agreements will benefit from a block exemption afforded to vertical agreements and thus fall outside the scope of the prohibition on anti-competitive agreements. (A vertical agreement is one that is entered into between businesses operating at different levels of the economic supply chain and includes, therefore, agency and distribution contracts). Parties may also be able to benefit from the "de minimis" exemption (where the contract is of 'minor importance' and is deemed not to appreciably restrict competition).

Exclusive agency or distribution contracts raise further competition law issues. Exclusive contracts raise the risk of reduced intra-brand competition and market partitioning, which may in particular lead to price discrimination – where most/all of the suppliers in a particular market apply exclusive distribution, this may facilitate collusion both at the suppliers' and distributors' levels.

The above demonstrates that competition law issues are complex and it is strongly recommended that principals (as well as agents) obtain expert advice on the particular arrangements relating to the agency or distribution relationship in question.

Tax

A non-resident company is not chargeable for profits deriving from income generated by sales of products or services to Italian residents; accordingly, entering into an agreement with a distributor for the territory of Italy would not make the non-resident manufacturer/supplier chargeable to Italian taxes.

The only exception might be caused by the fact that the non-resident company actually does business in Italy through an individual, formally described and registered in the Business Register as a mere representative, referring all commercial inquiries to its principal abroad, and thus generating no income within the Italian territory, but actually acting as a full branch of the non-resident company in Italy (full branches must be established through specific procedures, and are of course chargeable for the profits generated in the territory); the non-resident company would be thus liable for the taxes due by such a *de facto*, improperly opened full branch.

International Conventions

Italy ratified the United Nations Convention on Contracts for the International Sale of Goods through the Law # 765 of December 11, 1985, and the New York UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards through the Law # 62 of January 19, 1968; the Convention came into force on May 1, 1969.

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