

NEW COMMERCIAL AGENCY CONTRACT LAW

KNESSET ENACTS MAJOR CHANGE IN DEALING WITH COMMERCIAL AGENTS

MARCH 1, 2012

On February 20, 2012, the Israeli Knesset enacted a new law entitled the Agency Contract (Commercial Agent and Supplier) Law, 5772-2012¹ (the “**Agency Contract Law**” or the “**Law**”). The main purpose of the Law is to provide protection to Commercial Agents in their business dealings with Suppliers (both terms as defined in the Law and described below). The Law was inspired, at least in part, by the European Council Directive 86/653/EEC of 18 December 1986 on the coordination of the laws of the European Member States related to self-employed commercial agents. In effect, the Law supplements general contract principles with a series of provisions that seek to address asymmetries between Commercial Agents and Suppliers in order to protect Commercial Agents, who are perceived as the weaker party. Pursuant to Section 6 of the Law, the provisions of the Law serve as minimum terms for Agency Contracts, and deviations from the Law are only allowed to the extent that they are made in favor of the Commercial Agent. The Law will go into effect on April 27, 2012.

The Agency Contract Law applies to an **Agency Contract**, which is defined as a contract for consideration between a Supplier and a Commercial Agent in which a **Supplier** authorizes a **Commercial Agent** to solicit and engage new and existing clients to purchase tangible goods marketed by the Supplier, excluding real property, on an ongoing basis. The Law does not apply where the parties intend to create a partnership or employer-employee relationship. A Supplier is defined as either (a) a manufacturer and marketer of goods, or (b) a rights holder with respect goodwill and trademarks (whether registered or not) connected to goods, who markets such goods. A Commercial Agent is defined as a party engaged in locating clients or whose business operations aim to initiate contractual arrangements between a Supplier and customers in connection with the purchase of the goods marketed by the Supplier. Based on the foregoing definitions, as well as the explanations to the proposed Law, the Agency Contract Law is not intended to apply to a distribution contract in which the distributor actually purchases goods from the supplier.

Most significantly, the Law: (1) imposes minimum termination notice periods; (2) requires that a Supplier compensate a Commercial Agent if a Supplier notifies a Commercial Agent to stop working before the end of the notice period; and (3) requires a Supplier to compensate a Commercial Agent upon termination of an Agency Contract pursuant to a formula based on profits attributable to the Commercial Agent’s efforts in expanding the Supplier’s customer base. The Law also imposes a duty of loyalty on the parties and requires that they act faithfully towards one another (Section 3).

Prior Notice for Termination

Pursuant to Section 4 of the Law, either party to an Agency Contract of unlimited duration may terminate such contract at any time by providing prior written notice to the other party within a reasonable amount of time, and further provided that the notice period be no shorter than as stipulated in the Law itself. The minimum prior notice period according to the Agency Contract Law is as follows:

1 חוק חוויה סוכנות (סוכן מסחרי וספק), התשע"ב-2012

- Termination within the first 6 months – no less than 2 weeks;
- Termination within the second 6 months of the first year – no less than 1 month;
- Termination in the second year – no less than 2 months;
- Termination in the third year – no less than 3 months;
- Termination in the fourth year – no less than 4 months;
- Termination in the fifth year – no less than 5 months; and
- Termination in the sixth year or beyond – no less than 6 months.

However, as stated in Section 4(b) of the Law, if an Agency Contract stipulates that a longer termination period will apply, then such contractual provision will take precedence over the shorter notice period provided in the Law and the Agency Contract may not provide the Supplier with a shorter prior notice period than that which applies to the Commercial Agent. Pursuant to Section 4(d), if a fixed term Agency Contract is extended beyond its term, but the extension is of unspecified duration, then for purposes of calculating the length of the notice period, the contract period will be deemed to have commenced at the beginning of the initial contract.

Pursuant to Section 4(c)(1) of the Law, regardless of which party terminates the Agency Contract, the Supplier may notify the Commercial Agent to stop providing services before the end of the notice period. In such event, the Supplier is required to pay the Commercial Agent damages equal to the product of the early termination period (in months) multiplied by the Commercial Agent's average monthly profits in the shorter of (i) the half year preceding termination of the Agency Contract, or (ii) the second half of the contract term (the "**Early Termination Damages**"). However, in unique circumstances, the Court is authorized to adjust the amount of Early Termination Damages if it finds that the circumstances justify doing so, after taking into account changes in the condition of the marketplace, or in the industry in which the Commercial Agent operates.

Special Compensation for Expansion of Customer Base

In the event that either party terminates an Agency Contract, pursuant to Section 5 of the Law the Commercial Agent may be entitled to receive compensation reflecting the benefit accrued to the Supplier by virtue of its expanded customer base or a significant increase in the Supplier's business with customers ("**Business Growth Compensation**"). A Commercial Agent will only be entitled to receive Business Growth Compensation if all of the following apply: (1) the contract was valid for at least one year; (2) during the contract period, the efforts of the Commercial Agent resulted in an increased customer base; and (3) the Supplier benefited from new client relationships and an increase in its business, even after the end of the Agency Contract period. Pursuant to Section 5(c), a Supplier is not required to provide Business Growth Compensation if the Supplier terminated the Agency Contract following a breach of contract by the Commercial Agent.

If the Commercial Agent is entitled to Business Growth Compensation, such compensation will be equal to the product of the average monthly profits attributable to the expanded customer base and the increase in the Supplier's business with customers (as a result of the Commercial Agent's efforts), over the course of the three years prior to the termination, or the term of the Agency Contract, whichever is shorter, multiplied by the number of years that the Agency Contract was in force, for up to a maximum of twelve months. Thus, for example, if an Agency Contract was terminated after 15 years, and the average monthly profits attributed to the expanded customer base due to the Commercial Agent's efforts were US \$1,000 over that period, then the Commercial

Agent would be entitled to US \$12,000. Pursuant to Section 5(d), the court may reduce the Business Growth Compensation amount if it finds that it would be just and appropriate to do so.

As described above, the Agency Contract Law provides for court intervention in a number of instances and also contains provisions that are likely to be the source of future litigation, such as the concept in Section 5 regarding compensation for a “significant increase in the Supplier’s business.” In addition, the Law raises certain other questions arise, such as the application of the Law to existing contracts, which appears to be the case, and the implications of a choice of foreign law as the law of the Agency Contract.

This memo is provided for information purposes only. Please feel free to contact Peter Sugarman (peters@arnon.co.il) or Daniel Green (danielg@arnon.co.il) with any specific questions regarding the Agency Contract Law.