CHAMBER OF NATIONAL AND INTERNATIONAL ARBITRATION OF MILAN

Final award in case no. 1795 of 1 December 1996

Parties:	Claimant: Company X (US) Defendant: Company Y (Italy)
Place of arbitration:	Milan, Italy
Published in:	Unpublished. Original in Italian
Subject matters:	– termination of contract – UNIDROIT Principles

Facts

In 1983, the Italian company Y and the US company X entered into a joint venture which lasted until 1987, when Mr. Z, general manager of the US company, became the export director of the Italian company by a consultancy and brokerage contract concluded between the Italian company with the US company. The contract was entered into for two years and was tacitly renewable for the same period.

The contract was renewed twice and would have come up for a third renewal in the spring of 1994. In September 1993, however, the Italian company and Mr. Z negotiated an exclusive agency contract which was signed on 1 January 1994. The contract provided that Mr. Z would be based in Perth, Australia, as the Italian company's exclusive agent in the Far East.

The agency contract was concluded for a period of three years and was to be tacitly renewed unless notice of non-renewal was given six months before expiry (Clause 3). Clause 18 of the contract provided:

> "Each party may terminate this agreement before its expiry or renewal if the other party shall find that this agreement has been violated by the other party and the violation has not been cured. In case of termination by one of the parties, all the conditions of this contract shall be terminated as of the date of the notice, with the following exceptions: a) the

> agent shall leave all advertising and sales materials supplied by the principal at the principal's disposal on the agent's premises; b) the principal shall pay to the agent all commission fees for orders received, independent of when the orders have been accepted or confirmed or when delivery takes place or the invoices are issued by the principal."

The contract also contained a clause referring all disputes to the Chamber of National and International Arbitration in Milan.

On 23 January 1995, the Italian company Y, alleging unsatisfactory sales results, terminated the contract as of 1 January 1995 by a fax to Mr. Z personally. On 9 March 1995, the Italian company confirmed the termination by a letter to the US company X.

The sole arbitrator deciding ex aequo et bono and applying the UNIDROIT Principles of International Commercial Contracts, held that the unilateral termination of the agency contract was invalid as it was in violation of the terms of the contract and the UNIDROIT Principles. The arbitrator awarded the commission fees due to the agent at the contractually agreed rate of 15% as well as compensation for loss of profit.

Excerpt

I. DATE OF TERMINATION

[1] "On 23 January 1995, Mr. W, managing director of the Italian principal, sent a fax to Mr. Z, reading as follows:

> 'Dear Z, we have examined the results of your first year of activity as our agent in the Far East and we unfortunately have to conclude that they have not improved in your area in comparison to the time you were here.... We have received no new order from any Far East country, although that is a fast-growing area. Hence, as you have not met even half of your budget, please consider this letter as terminating our agency contract as of 1 January 1995. As to the licenses, on the contrary, we are open to further discussions if the contractual clauses are complied with and payment guarantees are given.'

On 9 March 1995, [Mr. W] wrote the following letter to the US company:

> 'We hereby confirm what we wrote on 24 January 1995 and, in so far as necessary, terminate the contract which we concluded with you on 1

> January 1994 because of your serious non-performance, since you have not met the sales target provided for in ... the said contract'.
> (....)

[2] "Clearly, the first issue is whether the agreement of 1 January 1994 was terminated on 23 January 1995 or on 9 March 1995. The arbitral tribunal finds that the date of 23 January 1995 prevails, considering: (a) that the fax of that date unambiguously expresses the Italian company's intention to terminate the contract of 1 January 1994 as of 1 January 1995; (b) that [Mr. W], who wrote both letters, declared to the arbitral tribunal:

> 'On 9 March I sent a formal termination of contract letter to the US company.... That letter was a mere formality, it was only a repetition of the letter of 23 January which this time I sent to the exact address, therefore I did not give further explanations. As far as I was concerned, the contract was terminated on 23 January';

(c) that during the arbitral proceedings the Italian company has always maintained that the decision was taken on 23 January 1995 and that the contract of 1 January 1994 was terminated as of that date. Hence, the fact that in its last statement the Italian company maintains for the first time that 'the Italian company did not in reality terminate the contract by its letter of 2[3] January 1995 but only suggested a modification of the contract, in the sense that the termination of the contract would have meant the end of all its effects, whereas the letter, leaving aside its wording, suggested a different relation to the US company, the 'continuation of the contract with reference to the licenses', is not consistent with the facts and the statements of the legal representative of the Italian company.

[3] "The date of 23 January 1995 is thus confirmed in law as being the date of termination of the contract of 1 January 1994. According to the interpretation rule in Art. 4.1 of the *UNIDROIT Principles of International Commercial Contracts* (UNIDROIT Principles), which also applies to the interpretation of unilateral acts such as a notice of termination of contract (see [the publication] *UNIDROIT Principles of International Commercial Contracts* [UNIDROIT] (Rome 1995), ad 1 p. 97), a contract must be interpreted: '(1) ... according to the common intention of the parties' and '(2) ... according to the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances'.

[4] "As this is a unilateral act, the sole 'intention' to be considered is that of Mr. W, the author of the notice of termination. As evidenced by Mr. W's above-mentioned statement, the fax of 23 January 1995 aimed at terminating

the contract of 1 January 1994. As far as the second alternative in Art. 4.1 UNIDROIT Principles is concerned, the fax of 23 January 1995 contained the words 'consider this letter as terminating our agency contract as of 1 January 1995'. It appears to the tribunal that the 'meaning' of these words does not leave any doubt as to the contents and impact of the Italian company's decision."

II. NO VALID TERMINATION

[5] "The termination of 23 January 1995 was prompted by the US company not having met 'even half of [the] budget'. The confirmation of said termination on 9 March 1995 (exclusively) referred to 'your serious non-performance, since you have not met the sales targets provided for in ... the said contract'. The Italian company maintained in the arbitration that the termination of the agency contract was due to 'repeated serious non-performances by the US company', that is, serious failure to meet the sales target provided for in the contract; illegal cashing of US$ 75,000 paid by a customer; modifications of the sales conditions for old customers of the Italian company, which had not been authorized by the Italian company, aimed at increasing [Z's] commissions; failure to communicate with the Italian company for a long time.

[6] "The tribunal shall examine the various grounds invoked by the Italian company to justify the termination of 23 January 1995, although it is established that the Italian company was motivated by the sole failure to meet the contractual sales target."

1. Failure to Reach the Contractual Sales Target

[7] ".... As to the facts: According to the Italian company, the 1994 sales in the countries exclusively covered by the US company were ITL 1,746,489,224 (on a target of 2 billion) for product A and ITL 50,207,226 (on a target of 800 million) for product B, the total being ITL 1,769,696,450. This sum is accepted by the US company. The tribunal notes that the failure to meet the contractual target for product A was moderate; not so for product B. A termination of the contract of 1 January 1994 because of a 'fundamental' non-performance could thus only concern product B.

[8] "As to the law: It must be mentioned in the first place that according to Art. 1.3 of the UNIDROIT Principles, the basic principle of contract law, that of '*pacta sunt servanda*' requires that

> 'a contract may be modified or terminated whenever the parties so agree. Modification or termination without agreement are on the contrary the exception and can therefore be admitted only when in conformity with the terms of the contract or when expressly provided for in the Principles'

(UNIDROIT pp. 9-10)."

2. Was the Termination Allowed under the Contract?

[9] ".... If no distribution or sales contracts were concluded, 'it will be decided by agreement if there will be a renegotiation as to the area and/or the agent's commissions'. Also, each party could terminate the agreement before its expiry 'if the other party shall find that this agreement has been violated by the other party and the violation has not been cured' (Clause 15 of the contract).

[10] "It clearly appears from the above that the parties to the contract explicitly intended that in case the sales target were not met (up to the point of not having concluded contracts or sales), the parties were to decide by agreement whether to renegotiate the area and/or the commission fees. Hence, the termination of the contract on this ground was excluded by the parties.

[11] "Further, Clause 18 of the contract, which concerns the possibility to terminate the contract before expiry, apparently should be interpreted, notwithstanding its meandering wording, in the sense that non-performance under the contract should be communicated to the non-performing party so that it could, if possible, remedy such non-performance. The Italian company does not contest that no oral or written warning preceded the termination of 23 January 1995. Hence, the termination was in any case not in agreement with the stipulations of the parties in the contract of 1 January 1994.

[12] "The same result is reached by applying the UNIDROIT Principles on termination. According to Art. 7.3.1 of the Principles, 'A party may terminate the contract where the failure of the other party to perform an obligation under the contract amounts to a fundamental non-performance'. In order to ascertain whether the non-performance, respectively the obligation which the non-performance concerns, is fundamental, we must again consider the intention of the parties. It seems impossible to deem fundamental for the termination a situation which was explicitly and expressly provided for by the parties to the contract as being renegotiable, by an agreement of the parties, as to the area or the commission fees.

[13] "The conclusion to be drawn from this analysis of the facts, the contract and the law applicable to the dispute is that the termination of the contract of

1 January 1994 on 23 January 1995 was unfounded. Hence, it is unnecessary to ascertain whether, as maintained by the US company and contested by the Italian company, the failure to meet the sales target was imputable to the Italian company, in particular in [certain cases]. If the failure to meet the contractual target did not as such allow the Italian company to terminate the contract, this is irrelevant for reaching a decision in this arbitration."

[14] The tribunal also rejected the Italian company's further allegations mentioned under [5].

III. EFFECT OF THE TERMINATION

[15] "Art. 7.3.5 of the UNIDROIT Principles provides: 'Termination of the contract releases both parties from their obligation to effect and to receive future performance'. Hence, both parties are freed of their obligations and may no longer rely on their rights under the contract of 1 January 1994. In particular, the US company may not, since 23 January 1995, use the name of the Italian company, either on its own or together with other words. It should be said that the US company has not objected to this legitimate request of the Italian company.

[16] "However, it must be stressed that, according to the explicit intention of the parties to the contract of 1 January 1994 (Clause 18), the termination of the contract entails that

> 'all the conditions of this contract shall be terminated as of the date of the notice, with the following exceptions: a) the agent shall leave all advertising and sales materials supplied by the principal at the principal's disposal on the agent's premises; b) the principal shall pay to the agent all commissions fees for orders received, independent of when the orders have been accepted or confirmed or when delivery takes place or the invoices are issued by the principal.'

[17] "A contractual obligation ex Clause 18 exists here. Indeed, Art. 7.3.5(3) of the UNIDROIT Principles provides that: 'Termination does not affect any provision in the contract for the settlement of disputes or any other term of the contract which is to operate even after termination'."

IV. DAMAGES

[18] "As the termination of the contract of 1 January 1994 was not in agreement with the contract and was not 'excused' under the UNIDROIT Principles (Art. 7.4.1),[1] the agent is entitled to the commission fees under the contract and also to compensation of the damages caused by the termination of 23 January 1995, which damages, according to Art. 7.4.2. of the UNIDROIT Principles, include 'both any loss which it suffered and any gain of which it was deprived, taking into account any gain to the aggrieved party resulting from its avoidance of cost or harm'."

1. Loss suffered

[19] ".... [T]he agent maintains that 'the Australian choice' was thought of and agreed upon in order to give effect to the agency contract stipulated with the Italian company, since nothing could have prevented the agent and the US company from requesting the continuation of the preexisting relationship in Italy, as [that relationship] was not terminated timeously by the Italian company. Hence, the US company claims the costs incurred by its managing director Mr. Z for settling down with his family in Australia, being ITL 198,227,000.

[20] "According to the comment to Art. 7.4.3 of the UNIDROIT Principles (UNIDROIT, ad 3 p. 218), harm must be certain and must be a direct consequence of the non-performance. It appears here that the expenses listed by the US company relate to the performance of the contract of 1 January 1994 and have not been caused by the termination thereof on 23 January 1995. This would not apply to the fact that Mr. Z had to sell his house because the [agency] contract was terminated before expiry. However, according to Art. 7.4.4 of the UNIDROIT Principles,

> 'The non-performing party is liable only for harm which it foresaw or could reasonably have foreseen at the time of the conclusion of the contract as being likely to result from its non-performance.'

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1. Art. 7.4.1 of the UNIDROIT Principles of International Commercial Contracts (UNIDROIT Principles) reads:

   "Any non-performance gives the aggrieved party a right to damages either exclusively or in conjunction with any other remedies except where the non-performance is excused under these Principles."

The purchase of a house by the agent does not fall under the above definition of damage.

[21] "We can add that it is doubtful that the US company, as a party to the contract of 1 January 1994, is the creditor for the expenses incurred by the family of Mr. Z. The arbitral tribunal holds that the US company may not claim a credit of another party, in casu the family of Mr. Z, in the arbitration. For the above reasons, the claim of the US company for a compensation of the expenses incurred by the family of Mr. Z for settling in Australia may not be granted.

[22] "The US company also claims as set-up costs 50% of the expenses for furnishing its office,... being ITL 21,759,105. The US company itself stresses that 'these costs would certainly not have been incurred if the Italian company had not stipulated ... the agency contract at issue'. The Italian company maintains that these expenses concern goods and services relating to the US company's activity. The contract provided that the US company would pay the costs relating to its activity as an agent, and that the Italian company would only pay commission fees. Hence, there is again no causal link between the termination of the contract of 1 January 1994 and the costs claimed by the US company according to Art. 7.4.4 of the UNIDROIT Principles discussed above.

[23] "Further, refunding the costs incurred for setting up the office would be contrary to Art. 7.4.2 of the UNIDROIT Principles, according to which 'the aggrieved party must not be enriched by damages for non-performance' (UNIDROIT ad 3 p. 215).

[24] "It should be noted that according to ... the contract, the agent was entitled to a compensation of 'legal costs', that is, apparently, of the legal costs incurred in the performance of its contractual obligations. However, the US company does not claim 'legal and commercial costs' under this heading and the sole invoice concerning legal costs submitted by the US company concerns Mr. Z's [taking up] domicile [in Australia] and is addressed to him and not to the US company. For the above reasons, the US company's claim for compensation of set-up costs may not be granted."

[25] The arbitral tribunal also rejected the US company's claim for certain costs incurred in the performance of the contract (travel, secretarial assistance, rent of the office, etc.) on the same grounds.

2. *Interest*

[26] The arbitral tribunal calculated the commission fees due to the agent and then discussed the issue of interest thereon. "The US company also claims interest at the contractually agreed rate of 15% on [certain invoices]....

According to Clause 14 of the contract, the commission fees 'shall be due and paid to the agent within 20 days from the date in which the Italian company received payment' and 'the late payment of commission fees due to a fault of the Italian company will entail payment of interest at a rate of 15% on all fees become due'.

[27] "First, this contractual clause is in conformity with the UNIDROIT Principles as to both the moment on which interest starts running (Art. 7.4.9)[2] and the agreed rate (Art. 7.4.13).[3] Second, although the US company clearly requested interest on the commission fees which had become due in its statement of 15 September 1996, the Italian company did not object thereto, although it knew of the invoices at issue, and thus of their dates of expiry, since 15 May 1996. Hence, interest at a rate of 15% shall be paid on the fees to which the above invoices refer, as confirmed by the tribunal in the present award, since their date of expiry and until final payment.

(....)

[28] "The US company also claims interest on late payment of invoices.... The Italian company does not contest the US company's claim. Taking into account the dates of expiry of the [invoices],... the interest due according to Clause 14 of the contract at the rate of 15% is the following: .... The US company claims that this interest should also run until final payment. In the absence of any specific provision in the applicable UNIDROIT Principles (Art.

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2. Art. 7.4.9 of the UNIDROIT Principles reads:

"(1) If a party does not pay a sum of money when it falls due the aggrieved party is entitled to interest upon that sum from the time when payment is due to the time of payment whether or not the non-payment is excused.

(2) The rate of interest shall be the average short-term bank lending rate to prime borrowers prevailing for the currency of payment, or where no such rate exists at that place, then the same rate in the State of the currency of payment. In the absence of such a rate at either place the rate of interest shall be the appropriate rate fixed by the law of the State of the currency of payment.

(3) The aggrieved party is entitled to additional damages if the non-payment caused it greater harm."

3. Art. 7.4.13 of the UNIDROIT Principles reads:

"(1) Where the contract provides that a party who does not perform is to pay a specified sum to the aggrieved party for such non-performance, the aggrieved party is entitled to that sum irrespective of its actual harm.

(2) However, notwithstanding any agreement to the contrary the specified sum may be reduced to a reasonable amount where it is grossly excessive in relation to the harm resulting from the non-performance and to the other circumstances."

7.4.9), the tribunal applies Italian law as the law applicable to the currency of payment (see UNIDROIT, ad 2 p. 228) and establishes the interest rate at 10% (Art. 1284 Italian Civil Code) from the date of the request in court (Art. 1283 Italian Civil Code) ... until final payment."
(....)

3. Loss of Profit

[29] ".... According to the above-mentioned Art. 7.4.2 of the UNIDROIT Principles, 'The loss of profit or, as it is sometimes called, consequential loss, is the benefit which would normally have accrued to the aggrieved party if the contract had been properly performed' (UNIDROIT, ad 2 p. 214). The contract of 1 January 1994 was concluded for three years and could be renewed tacitly for a further three years unless notice of non-renewal was sent six months before expiry. The letter of 23 January 1995, which could not validly terminate the contract, must be considered a notice of non-renewal according to Clause 3 of the contract.
[30] "According to Art. 7.4.2 of the Principles, the US company is entitled to find itself in the same situation in which it would have found itself if the contract of 1 January 1994 had been normally executed until its first expiry, that is, until 31 December 1996, always taking into account 'any gain to the aggrieved party resulting from its avoidance of cost or harm' (Art. 7.4.2.1 of the Principles)."
[31] The arbitral tribunal quantified the US company's loss of gain and concluded: "The US company suggests that the sum due for loss of gain be reduced by 20-25% in consideration of the costs which the US company would have incurred in the performance of the contract in the years 1995 and 1996. Art. 7.4.2.1 does indeed provide for such a reduction. The arbitral tribunal, deciding ex aequo et bono, establishes this reduction at 20%....
[32] "The US company also claims compensation of non-material damages caused by the allegedly 'extremely harmful' behaviour of the Italian company. The Italian company objects that the US company is not entitled to a compensation of non-material damages caused not the company but to its managing director. The tribunal notes on this point that the US company may not claim damages for harm done to Mr. Z, and that that harm, according to the UNIDROIT Principles and various legal systems, among which the Italian legal system, only concerns physical persons. Hence the terminology of 'loss of certain amenities of life' and 'aesthetic prejudice' (UNIDROIT, ad 5 p. 216) or 'health', 'aesthetic' or 'biological' prejudice (Cian/Trabucchi, *Commentario Breve al Codice Civile* (Milan 1994), ad Art. 2059 pp. 2131 et seq.). The US

company, being a company, cannot claim such damages; the US company's claim for moral damages cannot be granted by the tribunal."

V. COSTS

[33] "Considering that all the objections of the Italian company, as well as its request that the US company's claim be denied, are denied, and considering also the particular circumstances of the case and the long relationship between the US company and the Italian company before the termination of the contract, the tribunal directs the Italian company to pay all the costs of the arbitration as well as the costs incurred by the US company for its defence..., with interest thereon at the rate of 10% since the date of notification of the award until final payment.

[34] "These conclusions, which are reached in law, are not to be modified or mitigated in equity, the application of which the parties wished to moderate possible excesses of the law. The application of the law appears to lead to a satisfying balance of interests, so that the conclusions reached in law do not need to be mitigated in equity, also taking into account the agent's alternative work opportunities."