

A compensation for termination of a contract with an indefinite duration cannot be reduced

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The Spanish Supreme Court (SC) has recently ruled that a contractual compensation for termination of an indefinite contract cannot be reduced¹.

The case refers to a distribution agreement of "indefinite duration" allowing the distributor to terminate it at any time with a three-month prior notice by paying the supplier an amount equal to the net turnover of the previous two years.

The distributor decided to terminate the agreement but did not pay the agreed compensation and was sued by the supplier. A first instance court only partially upheld the claim² but, following an appeal by the supplier, the Madrid Court of Appeal (MCA) ordered the distributor to pay the full compensation provided for in the agreement.

The distributor then appealed the MCA's ruling, among others, on the grounds that it had not failed to comply with any obligation but exercised a right (termination) inherent in any indefinite contract pursuant to settled case-law.

The SC dismissed the appeal and declared that the compensation was payable and could not be reduced, "precisely", because it was not a penalty for breach of contract but "the price" for its termination which both parties (companies carrying on commercial activities, not consumers) had freely agreed.

According to the judgment, while penalty clauses *stricto sensu* (i.e. those provided for breach of an obligation) can be reduced pursuant to article 1,154 of the Spanish Civil Code³, a compensation provided for termination of an indefinite agreement cannot.

¹ Judgment 1471/2024 of 6 November 2024.

² The SC's judgment does not explain on what grounds.

³ "The judge will equitably modify the penalty when the primary obligation had been partially or irregularly fulfilled by the debtor".

See our note of June 2022 (*Freedom of contract and penalty clauses*) on the SC's judgment 371/2022 of 20 April 2022, which reminded that, according to settled case-law, a penalty can also be reduced if (i) it is extraordinarily higher than the damages reasonably foreseen at the time of the agreement or (ii) said damages turn out to be extraordinary higher than the actual damages due to an unpredictable change of circumstances.