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Goodwill Indemnity / Portfolio Compensation



1. What is portfolio compensation?

Portfolio compensation, also known as goodwill indemnity or clientele compensation, is one of the consequences of the end of an agency agreement. It is the compensation to be paid to the agency, which expanded the client's business volume during their agreement, to balance out its efforts toward such increase in value on an equitable basis.

This type of compensation cannot be renounced or waived in advance. Therefore, any contractual provisions executed prior to the expiration of the contract that could prevent or limit goodwill indemnity with future effect are also void.

2. What types of contracts may raise the issue of portfolio compensation? Scope of application?

Goodwill indemnity/portfolio compensation is not only applicable to agency contracts, but also to continuing performance contracts that provide monopoly rights such as sole dealership, insurance agency, franchise, and trademark license.

3. Conditions of portfolio compensation: Who can claim portfolio compensation and under which circumstances? What is the time limitation applicable to the claim?

a. The contract must have ended. Portfolio compensation cannot be claimed if the contract is terminated by the agency without any action on part of the client to justify such termination or by the client on justifiable grounds due to the fault of the agency.

b. The client must be able to continue to derive significant benefits from the customers brought in by the agency, even after the end of their contractual relationship.

c. The agency must incur loss of commissions due to the ending of the contract.

d. The payment of the goodwill indemnity must be equitable.

The agency must claim such compensation within 1 year of the end of the contractual relationship.



4. How is the amount of portfolio compensation calculated?

The relevant articles of the Turkish Commercial Code do not include a detailed methodology for calculating the exact amount of the portfolio compensation. The method in the law rather specifies the procedures on how the upper limit of the portfolio compensation, that is, the maximum compensation amount that the agency may be entitled to, should be determined. It should also be noted that the portfolio compensation claim will be subject to an equity assessment by the court.

i. How are the ceiling amounts for portfolio compensations calculated?

According to Article 122 of the TCC, the method to be used to determine the maximum compensation amount the agency is entitled to varies according to the duration of the contractual relationship. Whether the contract period covers more or less than five years determines the method to be used.

✓ Cases where the duration of the contract is longer than 5 years

The legislation determines the ceiling amount of the portfolio compensation for contracts with a duration of five years or more, stating that the compensation amount “may not exceed the average of annual commissions or other remunerations received by the agency as a result of the last five years of activity”. As understood from the provision, there is no detailed imperative provision regarding the calculation method, and only a superficial definition and the ceiling amounts are provided.

✓ Cases where the duration of the contract is less than 5 years

In cases where the contractual relationship lasts less than five years, the relevant provision states that the ceiling amount shall be calculated based on “the average during the continuation of the activity”.

The fact that the law does not regulate the maximum compensation amount claimable by agencies and the individual conditions regarding the calculation methods makes it difficult to establish a unity of practice and a reasonable calculation approach.

ii. What are the issues that should be considered carefully when calculating the ceiling amount of portfolio compensation?

The calculation of the portfolio compensation should be based on the accounting records, income statements, and client portfolio of the agency or sole dealer. Although the aforementioned items seem very clear, many concepts and approaches in these fields also cause controversies.

Of course, the conflicting issues may differ according to the case and sector, and it is possible to increase the number of examples. However, some of the issues that are observed to cause controversy in terms of the calculation of portfolio compensation and that should be carefully considered while calculating are as follows:

- What the concept of “commission or other remuneration” specified in the law corresponds to in the world of accounting
- Fixed and variable expenses
- Geographical exclusivity
- Definition of customer portfolio
- Sales outside the customer portfolio
- New customer acquisition and customer loss rates during the contract period
- Competitiveness of the relevant industry
- The beginning and end of the five-year period stipulated by the law
- Unusual market fluctuations over the five-year period
- Whether or not the portfolio compensation calculation can be calculated as a prediction/projection for the future
- Taxes paid by agency or sole dealer
- Sales, marketing and advertising expenses
- Product recognition
- Customer loyalty
- Income from after-sales services
- Whether or not the marketing strategy was determined by the agency or the sole dealer
- Status of idle sales and marketing investments

As can be seen, the calculation of portfolio compensation can be more complicated and challenging than anticipated from time to time. The above factors should be carefully considered according to the actual case on hand, and the calculation should be revised according to the requirements of the concrete case.

iii. Which conditions are taken into consideration by the court in the equity assessment?

The characteristics of the concrete case are taken into consideration while assessing equity. For example;

- The entire contractual relationship;
- Reasons for the termination of the contract;
- Whether the parties are at fault;
- The duration of the contract;
- Developments in the customer environment;
- Brand recognition;
- Prohibition of competition;
- Advertising and promotional activities;
- Gains and losses of the parties as a result of the termination of the contract;
- Issues such as risk sharing between the contracting parties may be subject to evaluation.

The amount of the receivable can be reduced or increased as required by the principle of equity depending on the characteristics of the concrete case. For example, if the reputation of the client’s brand has been effective in the formation of the new customer environment, an appropriate reduction can be made in the amount of the receivable. If the agency has made extraordinary efforts with significant advertising and promotional activities, the amount of the receivable can be increased as a matter of equity. As a result, the agency’s goodwill indemnity is calculated by applying an element of equity as well.

iv. Consideration of unprecedented periods and trends in the past while calculating the portfolio compensation ceiling amount (Covid-19 etc.)

It is understood that in the calculation of portfolio compensation, the financial performance in the five-year period prior to the expiration of the contract will be considered, and in the case of a shorter contractual period, the financial performance during the term of the contract will be taken as a basis. It should be noted that the calculation of the average of the relevant period is to determine the routine or ordinary financial performance of the agency or sole dealer.

From time-to-time extraordinary market conditions and consequently exceptional financial performances may be observed during the period used as the basis for calculating the average. The most recent example of such circumstances is the Covid-19 pandemic being experienced throughout the whole world since December 2019.

Some businesses have been affected by the Covid-19 outbreak in an unusually positive manner, while others in an unusually negative way. Therefore, appropriate questions should be asked before including the revenue and profitability of these enterprises during the pandemic into the average exactly as is. It is possible to add to the number of such unprecedented examples. We can easily include airline companies and tourism agencies that were badly affected by a volcanic eruption, or the distributor in Turkey of a product of Ukrainian origin, which was adversely affected by the Russia-Ukraine crisis. Therefore, it should be noted that one of the important elements in portfolio compensation calculations is the effects of environmental factors on the financial situation.

Whether such cases should be considered by the judge during the equity assessment or by the expert or specialist calculating the portfolio compensation is a matter of contention. However, it is indisputable that the effects of Covid-19 will play an important role in portfolio compensation claims in the next five years and cause differences of opinion.

5. Are contractual clauses governing the calculation of portfolio compensations valid?

If the parties specify a calculation method considered more disadvantageous for the agency compared to the calculation method stipulated by the law, this will not be valid. On the other hand, if the formula allowing a higher claim amount for the agency has been agreed upon in the contract, this provision will be applied.



6. What are the other notable aspects regarding portfolio compensation?

i. Is it possible to claim portfolio compensation following the expiration of fixed term contracts? Does the length of the contract period effect the portfolio compensation claim?

Portfolio compensation can also be claimed in the event of the expiration of a fixed term contract. While the length of the contract period does not have a direct effect on the portfolio compensation claim, it can be taken into account when conducting an equity assessment.

ii. Does the party claiming portfolio compensation have to prove its sales-marketing activities?

Since the sales and marketing activities regarding a product demonstrate the contribution of the agency to the client's customer environment, it may be important to prove the sales and marketing activities.

iii. Must the contract include a regional exclusivity clause in order for the agency to be able to claim portfolio compensation?

According to the Turkish Commercial Code, provided that it does not violate the principle of equity, portfolio compensation claims are applicable in cases of the expiration of continuing performance contracts granting monopoly rights such as the sole dealership and so forth. The law clearly includes the expression "continuing performance contracts granting similar monopoly rights", and it is understood that the legislator intended to limit the referred article to only include contracts granting monopoly rights. On the other hand, a monopoly right is not a mandatory/typical element of agency agreements, and as such is not included as a condition for portfolio compensation. It is asserted in the doctrine that, deeming it obligatory for agency-like contracts to include a monopoly right clause as per Article 122/5 of the Turkish Commercial Code would be a violation of the equity principle, since such a clause is not mandatory for claiming portfolio compensation under agency contracts.

iv. What is the effect of the popularity of the product's brand abroad on the formation or development of the customer environment in the authorized region?

As a rule, it is accepted that the popularity of a product's brand abroad does not have a direct effect on the development or creation of the customer environment in a sales region. However, the contrary can be proved by the client/provider with other evidence.

Contact:



Oytun Önder

Forensic, Commercial
Dispute and
Compliance,
Partner
oonder@kpmg.com



Batuhan Tellioglu

Forensic, Commercial
Dispute and
Compliance,
Senior Manager
btellioglu@kpmg.com



Deniz Altınay

Partner,
Attorney At Law
d.altinay@pekin.com.tr



Hande Alp

Senior Associate,
Attorney At Law
h.alp@pekin.com.tr

For detailed information:

KPMG Turkey
Clients & Markets
tr-fmmarkets@kpmg.com

Pekin Bayar Mizrahi

Address: Ahşar Sokak No:15,
34337 Etiler İstanbul
T: +90 212 359 57 00

İstanbul

İş Kuleleri Kule 3 Kat 1-9
34330 Levent İstanbul
T : +90 212 316 6000

Ankara

The Paragon İş Merkezi Kızılırmak Mah. Ufuk
Üniversitesi Cad. 1445 Sok. No:2 Kat:13
Çukurambar 06550 Ankara
T: +90 312 491 7231

İzmir

Folkart Towers Adalet Mah. Manas Bulvarı
No:39 B Kule Kat: 35 Bayraklı 35530 İzmir
T : +90 232 464 2045

Bursa

İnallar Caddesi Plaza, Balat Mahallesi Mudanya
Yolu Sanayi Caddesi No: 435 K:5
D:19-20 Nilüfer
T : +90 232 464 2045

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