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A party that wrongfully terminates a contract may also be held liable towards third parties

The principle is not new but deserves to be recalled: A party that breaches its contractual obligations may be held liable not only towards its co-contracting party but also towards third-parties.

This was re-affirmed by the *Cour de Cassation* (French Supreme Court) in a decision issued on October 20, 2015 in connection with a dispute related to the wrongful termination of an exclusive license agreement.

This decision is interesting to analyze, particularly with respect to third-parties, as it confirms that the latter may be awarded significant damages in compensation for the loss they have suffered as a result of the termination.

Agreements produce effect only between the contracting parties. Under this principle of privity of contracts, agreements do not, in principle, harm or benefit third-parties[1].

Yet, *vis-à-vis* third-parties, agreements may have the effect of creating factual situations which have legal consequences.

As such, third-parties may be imposed the obligation to respect the contractual relationships established between contractual parties[2]. Further, if a third-party has, with full knowledge of the facts, helped one of the contracting parties breach its contractual obligations, it may be held liable in tort towards the non-breaching party[3].

Conversely, according to a well-established case-law, a third party to a contract may invoke, in tort[4], a contractual breach insofar as this breach has caused it a loss.

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This principle was re-affirmed by the Plenary Assembly of the *Cour de Cassation* in a decision rendered on October 6, 2006[5]. Specifically, in that case, the *Cour de Cassation* admitted that the lessee-manager of a business going concern (*fonds de commerce*) operated within premises leased under a commercial lease agreement could bring a tort claim against the landlord because – even though he was not a party to the lease agreement – he had suffered a damage as a result of the landlord's contractual breaches (in that case, poor maintenance of the premises). The lessee-manager thus obtained the restoration of the premises to their original condition and the payment of a provisional indemnity to compensate for his loss of earnings.

Thereafter, judges have consistently applied this principle.

The *Cour de Cassation*, however, specified that the trial judges ought to ascertain why the contractual breach that they recognized as being established could serve as a basis for a tort claim by the third-party, and why such breach caused a damage to the latter[6].

Third-parties usually bring claims for indemnification in relation to contractual breaches that occur during the performance of the contract. Yet, such breaches may also occur at the time the contract is terminated by one of the contracting parties.

In this respect, in a case where the car dealership agreement entered into between a manufacturer and a car dealer had been terminated by the manufacturer, the *Cour de Cassation* held that the parent company of the dealer was entitled to bring a claim for wrongful termination to obtain compensation for the specific loss that the termination had caused it[7].

The October 20, 2015 decision[8] provides a new illustration of a wrongful termination of a contract by a party that led the court to order the latter to indemnify a third-party for the loss suffered by it as a result of said termination.

In the commented case, a company had been set up by two shareholders in order to operate hairdressing salons in Russia (the "Operating Company"). The Operating Company had entered into an exclusive license agreement for the use of an internationally well-known trademark (the "Agreement"). Then, one of the shareholders (the "Promisor") undertook to acquire the shares held by its co-shareholder (the "Beneficiary") for a price of USD 775,000. The licensor of the trademark (the "Licensor") then terminated the Agreement, claiming contractual breaches by the Operating Company. The Operating Company was placed in judicial liquidation. The promise to purchase the shares entered into between the two shareholders had not been performed, and was then cancelled by the court on the ground that the Promisor's consent had been vitiated because of an error about the essential qualities of the shares. The Promisor indeed argued that it would not have made the commitment to purchase the shares – that had lost all of their value as a result of the termination of the Agreement – if he had been aware of the facts alleged by the Licensor against the Operating Company. A few months later, the Licensor was found liable for wrongful termination and ordered to pay damages to the court-appointed agents involved in the liquidation proceedings initiated against the Operating Company.

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The Beneficiary then brought a legal action against the Licensor and, arguing that the breaches committed by the latter had caused him a specific loss, sought damages.

On appeal, the Licensor was ordered to pay the Beneficiary the sum of EUR 500,000 in damages.

In the decision commented herein, the *Cour de Cassation*, having recalled the principle according to which "*a third-party may invoke, in tort, a contractual breach if such breach has caused it a loss*", noted that the Beneficiary had found himself unable to enforce the commitment and to receive the sale price, as the promise to purchase had been canceled given the circumstances in which and the reasons for which the Agreement had been terminated. As the termination had finally been held wrongful the *Cour de Cassation* inferred that the Licensor had, by virtue of his conduct, caused a specific loss to the Beneficiary.

The Licensor also claimed that the Court of Appeals had erred in arbitrarily assessing the loss at EUR 500,000 without ascertaining the value of the shares that remained in the Beneficiary's possession. The Licensor considered that, in any case, the loss suffered by the Beneficiary could not exceed the difference between the agreed price (USD 775,000) and the value of the shares. Yet, considering that the appellate judges had, in their full discretion, assessed the loss at EUR 500,000, the *Cour de Cassation* also upheld that part of the judgment of the Court of Appeals.

As such, this decision confirms that the wrongful termination of a contract may not only have consequences beyond the relationship between the parties, but also turn out to be very costly for the terminating party.

[1] Article 1165 of the French Civil Code

[2] 1st Civil Chamber of the *Cour de Cassation*, April 20, 1982: Bull. civ. I, n°139, p.123

[3] 1st Civil Chamber of the *Cour de Cassation*, January 26, 1999: Bull. civ. I, n°32, p. 21; Commercial Chamber of the *Cour de Cassation*, October 11, 1971: D. 1972, 120

[4] Article 1382 of the French Civil Code

[5] Plenary Assembly of *Cour de Cassation*, October 6, 2006, 05-13.255

[6] 1st Civil Chamber of the *Cour de Cassation*, December 15, 2011, n°10-17.691

[7] Commercial Chamber of the *Cour de Cassation*, October 21, 2008, n°07-18487

[8] Commercial Chamber of the *Cour de Cassation*, October 20, 2015, n°14-20540

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