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French contract law reform: Consequences on contractual practices in distribution arrangements

The provisions set forth in Ordinance n°2016-131 of February 10, 2016 for the reform of contract law, the general regime of obligations and proof of obligations (the "Ordinance") will come into force on October 1, 2016 and apply to all contracts entered into on or after said date.

This major overhaul of French contract law will entail practical changes in contractual practices with respect to distribution agreements. This Article provides a few examples of anticipated changes regarding the formation, performance and substance of distribution agreements.

1. Regarding contract formation

Generalization of the good faith principle during the pre-contractual phase

The requirement that parties must act in good faith – that was so far limited to the contract performance phase as per Article 1134 of the French Civil Code – is now extended to the contract negotiation and formation phases and to the breakdown of negotiations.

According to the amendments brought about by the Ordinance, "*contracts must be negotiated, formed and performed in good faith*" (new Article 1104 of the French Civil Code). In addition, "*parties are free to start, conduct and break-off pre-contractual negotiations*", provided that "*good faith is imperatively observed*" (new Article 1112 of the French Civil Code).

While the scope of these changes appears limited since case-law had already established that the good faith

principle should prevail during the pre-contractual phase, such changes obviously reinforce this principle and the parties' obligation to abide thereby.

As such, due consideration must be given to the parties' compliance with this good faith principle during the negotiation and formation of distribution agreements. In this respect, it may be useful for the parties to include contractual representations on due compliance with this requirement.

Enshrinement of a general duty to disclose information during the pre-contractual phase

The generalization of the good faith principle must be combined with a general duty to disclose information during the pre-contractual phase imposed on the contractual parties as a result of the reform. As such, "*the party who is aware of a piece of information which is decisive for the consent of the other party, shall inform such other party of the same insofar as the latter legitimately ignores such information or trusts its co-contracting party*" (new Article 1112-1 of the French Civil Code).

Breach of this obligation may trigger the liability of the breaching party and entail the nullity of the contract on the ground of vitiated consent.

This innovation has consequences for heads of distribution networks.

In their relationships with heads of distribution networks, distributors may henceforth invoke a general duty to disclose information not only on the basis of a specific piece of legislation, i.e. Articles L. 330-3 and R. 330-1 of the French Commercial Code, but also under the general rules introduced in the French Civil Code by the reform.

The kind of information that may be required to be disclosed under new Article 1112-1 of the French Civil Code seems wider that what is exhaustively listed in Article R. 330-1 of the French Commercial Code. As such, regarding franchise agreements, it would be legitimate to wonder whether franchisors will be required under the general rules introduced by the reform to disclose forecast income statements to the franchisees.

Moreover, heads of distribution networks will now be able to invoke a specific piece of legislation to bring a liability action or an action for invalidity of the contract wherever the distributor has failed to disclose information that would have been critical for its decision to enter into the contract.

Introduction of the concept of "economic duress"

Regarding the applicable requirements for a contract to be valid, the concept of economic duress is introduced as a defect of consent and will be established wherever a party, abusing from the state of dependency of its contractual partner, obtains from the latter "*a commitment that would not have been agreed to in the absence of such constraint, and derives a manifestly excessive benefit therefrom*" (new Article 1143 of the French Civil Code).

With respect to distribution arrangements, it will be necessary to carefully consider the relationships

established with a dependent supplier or, insofar as possible, to resort to a commercial partner that carries out diversified business activities.

2. Regarding the substance of contracts

Significant imbalance in "standard form" contracts

The Ordinance provides the following definition of a "standard form" contract: A contract "*the terms and conditions of which, excluded from negotiations, are determined in advance by one of the parties*" (new Article 1110 of the French Civil Code).

For this type of contracts, there exists a public policy provision according to which "*any clause that creates a significant imbalance between the rights and obligations of the contractual parties shall be deemed unwritten [i.e. ineffective]*" (new Article 1171 of the French Civil Code), it being specified that the assessment of the existence of a significant imbalance may be based neither on the main subject-matter of the contract nor on the adequacy of the price to the service.

This new provision will most likely be used by suppliers wishing to challenge the substance of the "standard form" contracts offered by their distributors, or vice-versa.

Contracting parties will henceforth have the option to rely either on the specific legislation set forth in Article L. 442-6 I, 2° of the French Commercial Code – under which the fact of imposing unbalanced rights and obligations may trigger the liability of the relevant party and result in the relevant provision(s) being held invalid – or the general rules introduced in the French Civil Code by the reform.

In any event, contracting parties are encouraged to make sure they can produce evidence that a negotiation has taken place and to avoid offering contracts that contain unilateral obligations or disproportionate or discretionary rights or, as the case may be, be at least able to provide adequate objective justification for such obligations and rights.

New framework for the unilateral determination of prices

Regarding framework agreements (i.e. long-term agreements that define general provisions governing the relationship between the parties), the reform provides that a party may unilaterally set the price "*provided that it can, in case of a dispute, justify the set price*" (new Article 1164 of the French Civil Code).

Wherever there has been an abuse in the determination of the price, the other contracting party may go to the judge to seek damages and/or request the termination of the agreement.

This provision enshrines the solution developed by case-law, with the difference, however, that the burden of proof is reversed. As such, if this possibility to unilaterally fix the price has been expressly stipulated in a

supply contract, the supplier must keep the proof that the price that has been set for its products, or any variation thereof during the performance of the contract, is well-founded.

3. Regarding the performance of contracts

Introduction of the theory of unforeseeability

The reform introduced in the French Civil Code the concept of unforeseeability, according to which a contracting party is entitled to request the renegotiation of the contract whenever "*a change of circumstances unforeseeable at the time of the conclusion of the contract renders its performance excessively onerous for one party, who did not accept to bear such risk.*" The party that requests such renegotiation must continue to perform its obligations during the renegotiation period. *"If renegotiation is refused or falls through"*, the parties may agree to have the contract rescinded or, by common agreement, ask the court to set about the adaptation of the contract. If they cannot reach an agreement within a reasonable period of time, either party may ask the court to revise or terminate the contract (new Article 1195 of the French Civil Code).

It should be noted that this review mechanism by the judge is not a public policy provision. As such, the application of this default provision can be set aside or specifically adapted by the parties in distribution agreements.

Defense to improper performance as a preventive measure

The reform introduced a new sanction in case of improper performance of the contract. Specifically, a party can suspend the performance of its obligations if it is clear that its co-contracting party will not perform its own obligations on a timely basis and that the consequences of this non-performance will be sufficiently serious for it (new Article 1220 of the French Civil Code).

The enforcement of this means of defense as a preventive measure can turn out to be quite useful wherever obligations imposed under a distribution agreement are not met. It will however likely be necessary to define in the agreement what is to be understood by a "*sufficiently serious*" breach – or even risk of "clear" breach – in order to pursue this remedy. Indeed, the relevant party must be able to establish that the consequences of the anticipated non-performance have a sufficient degree of seriousness, failing which its liability could be incurred.

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