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French contract law reform: What consequences on the rules of representation within corporate groups

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") came into force on October 1, 2016.

One of the innovative provisions introduced by the reform is codified in new Article 1161 of the French Civil Code under which a so-called "*contract with oneself*" which creates a conflict of interest in representation is void.

The implementation of this provision will raise difficulties, in particular with respect to its articulation with other rules set forth in the French Commercial Code and that apply, in particular, within corporate groups.

1. The Ordinance limits the powers of the legal representative

New Articles 1145 to 1161 of the French Civil Code (the "FCC") enshrine the representation mechanism and introduce general rules concerning the capacity and the representation of contracting parties.

With respect to legal entities, these Articles set the legal framework for the representation of such entities by their legal representatives.

More specifically, new Article 1161 of the FCC sanctions perceived conflicts of interest in contracts signed by a same person who acts as representative of both contracting parties.

In this situation, new Article 1161§1 establishes the principle of a dual restriction:

"*A representative may not act on behalf of both parties to a contract nor can he/she contract on his/her own behalf with the person he/she represents*".

As such, a contract signed by the same person can be declared void wherever such person acts:

- as representative of both contracting parties (dual representation). In practice, this is especially the case where the same person, as legal representative of two companies, signs a contract on behalf of these two entities;
- both as representative and as the person represented (so-called "*contract with oneself*"), i.e. a situation that arises wherever the legal representative contracts, in his/her personal capacity, with the company that he/she represents.

It should be noted that the term "legal representative" means the managers of *sociétés civiles* (civil companies), *sociétés en nom collectif* (partnerships) and *sociétés à responsabilité limitée* (limited liability companies), the President of *sociétés par actions simplifiées* (simplified joint stock corporations), the managing directors of *sociétés anonymes* (joint stock corporations) and, in certain circumstances, the managing directors or chief executive officers of *sociétés par actions simplifiées* (simplified joint stock corporations).

The desired objective is, above all, to protect the person represented who, as per new Article 1161§2 of the FCC, will be entitled, in order to "save" the contract, to authorize it or ratify it *a posteriori*:

"*Where he/she does so, any act which is concluded is null and void unless legislation authorizes it or the person represented has authorized or ratified it*".

In the absence of authorization or ratification, the penalty is severe, even though it will indisputably be relative (the nullity can only be sought by the parties to the contract), since it aims at protecting a private interest, i.e. the interest of the represented company.

But the question arises as to how these new constraints will be combined with the provisions of the French Commercial Code concerning the control of certain agreements within corporate groups.

2. Articulation of new Article 1161 of the FCC with French corporate law

Under the French Commercial Code, corporate law includes specific rules concerning the prohibition or approval of certain agreements that may pose conflict of interests, in particular within corporate groups. It makes a distinction between agreements that are prohibited outright and so-called "regulated" agreements that are subject to a control procedure by the shareholders of the relevant company, precisely in order to prevent conflicts of interest.

The difficulty here concerns the so-called “free” agreements, i.e. agreements that pertain to ordinary transactions and that are entered into under normal terms and conditions, and the agreements concluded between two companies, one of which holds, directly or indirectly, all of the share capital of the other.

These “free” agreements fall outside the scope of the control procedure applicable to “regulated” agreements provided for in the French Commercial Code, but should they now be authorized or ratified, as per new Article 11621 of the FCC?

In this respect, it is necessary to refer to new Article 1105§3 of the French Civil Code that stipulates that “*General rules are applied subject to particular rules*”. The Report to the President of the [French] Republic that was annexed to the Ordinance (Official Journal of February 11, 2016, text n°25) added the following clarification in relation to said Article: *“[….] the general rules laid down by the Ordinance shall be set aside in particular wherever it will be impossible to apply them concurrently with some of the rules enacted by the [French] Civil Code to regulate special contracts, or those resulting from other Codes such as the [French] Commercial Code of the [French] Consumer Code”*.

Today, legal writers have different opinions on what position should be adopted. Some consider that the new general contract law, including new Article 1161 of the FCC, must apply insofar as corporate law is silent on this point; this analysis is supported by the objective of protection pursued by said Article. On the other hand, some legal writers consider that the corporate law rules should apply as “*the silence of the law on specific points must be interpreted as a deliberate intention not to impose rules*” (BRDA 9/2016).

As no clear position is being taken on this issue, corporate officers must be cautious.

In practice, if there are several legal representatives, the difficulty can be circumvented by having the contract signed by the legal representative who has no legal interest therein.

If there is only one legal representative, the latter must either obtain *a posteriori* the ratification of the contract by the shareholders – with the risk that such ratification be denied – or obtain the prior authorization of said shareholders – which can be burdensome if such authorization is to be granted on a case-by-case basis.

Since new Article 1161 of the FCC does not specify whether this authorization is subject to certain formalities, some legal writers are considering the possibility of adopting a general resolution authorizing legal representatives to sign agreements likely to be declared void under said Article. Others suggest that the by-laws should include a specific mention authorizing the shareholders or any other corporate bodies that appoint the legal representative to exempt the latter from the limitations set forth by new Article 1161 of the FCC.

Yet, all those who have so far commented on this Article agree that extreme caution should be exercised so long as French courts have not uphold the general authorization and/or exemption schemes that may be put in place.

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