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Significant imbalance in the parties' rights and obligations

Following a legal action brought by the Minister of the Economy (the "Minister"), the Paris Court of Appeals (the "Court") held, in a judgment issued on November 20, 2013, that two clauses of a distribution contract – one concerning the terms and conditions of termination of the contract and the other concerning the applicable payment terms – created a significant imbalance in the parties' rights and obligations, which resulted in a serious disturbance of public economic order[1].

Subsequently, in a judgment handed down on December 18, 2013, the Court, asked to adjudicate a case referred to it in similar conditions, sanctioned other clauses that created a significant imbalance in the rights and obligations of the parties to a distribution contract[2]. In both cases, the Court ordered the discontinuation of the unlawful practices and imposed on the distributor a civil fine of 250,000 Euros in the first case and 500,000 Euros in the second case.

Law n°2008-776 of August 4, 2008 for the Modernization of the Economy, known as the "LME Law", has radically reformed the legal framework governing commercial relationships between business partners.

The LME Law has notably defined a new practice that restricts competition ("restrictive trade practice"), sanctioned under Article L. 442-6 I §2 of the French Commercial Code according to which "*The fact, for any producer, trader, industrial company or person registered in the Trade Directory to subject or to attempt to subject a business partner to obligations that create a significant imbalance in the rights and obligations of the parties, shall trigger the liability of the perpetrator thereof and shall obligate said perpetrator to compensate the harm caused thereby*".

To make sure that the provisions set forth in Article L. 442-6 of the French Commercial Code are effectively enforced, the Minister is entitled to initiate legal proceedings to ensure compliance therewith.

The LME Law specifies that "*in the framework of these proceedings, the Minister of the Economy and the public prosecutor may request the court hearing the case to order the discontinuation of the practices set forth in this Article. For all these practices, they may also request the court to acknowledge the nullity of the unlawful clauses or contracts and to order the refund of the sums unduly paid. They may also request the court to impose a civil fine, the amount of which may not exceed 2 million Euros*".

The definition of this new restrictive practice has notably filled the vacuum left by the removal of the prohibition of the abuse of economic dependency by the LME Law.

In its judgments dated November 20 and December 18, 2013, the Court provides concrete examples of contractual clauses that subject a business partner to obligations that create a significant imbalance in the parties' rights and obligations.

These judgments, that take place in the trend of still sparse decisions, should be given credit for providing an instructive illustration of a concept that has been much criticized by legal writers for its lack of precision.

1. A vague, uncertain and unconstitutional concept?

Since the introduction of this restrictive practice, French legal writers strongly criticized the concept of "significant imbalance". Application n°2010-85 for a priority preliminary ruling on the issue of constitutionality was filed with the Constitutional Council that thus was asked to rule on the constitutionality of these newly introduced provisions[3].

Specifically, the legislator was criticized for having created an incrimination that allegedly infringed the principle of legality of offenses and punishments enshrined in Article 8 of the 1789 Declaration of the Rights of Man and of the Citizen which requires it to define in sufficiently clear and precise terms the requirement which carries a penalty in case of non-compliance.

In its decision dated January 13, 2011, the Constitutional Council ruled that the concept of significant imbalance had been defined in sufficiently clear and precise terms to comply with the principle of legality of offenses and punishments, insofar as the legislator "*referred to the legal concept of significant imbalance in the parties rights and obligations set forth in Article L. 132-1 of the [French] Consumer Code (…); by referring to this concept, the scope of which has already been specified by case-law, the offence is defined in conditions which enable the judge to make a ruling without his interpretation being challenged as being an arbitrary interpretation. Furthermore, the court to which the case is referred may, as per Article L 442-6 III §2 of the [French] Commercial Code, consult the Committee for the review of commercial practices which is composed of representatives of the commercial sectors involved.*"

Despites the decisions rendered by the Constitutional Council, criticisms on the lack of precision of the concept of significant imbalance are still being expressed.

For instance, the Minister Delegate for the Social and Mutually-Supportive Economy and Consumer Affairs

was asked to clarify what this concept really covers; a concept considered by MP François Brottes "*as too vague to truly secure the contractual relationships between suppliers and distributors and to enable them to adapt to the supply characteristics that are specific to some business sectors*"[4].

The Minister recalled that "*it is the transversal nature of the "significant imbalance" concept that makes it an efficient weapon against abuses*".

To reject the criticisms on the lack of precision of this concept, the Minister notably replied that the analysis of the (dozen or so) decisions issued in relation to this concept, following proceedings initiated by the Minister, helped identifying the types of clauses likely to create a significant imbalance.

According to the Minister, the rendered decisions show that the following clauses are notably likely to be held as creating a significant imbalance:

- Clauses that apply without distinction to all business partners belonging to the same entity, therefore suggesting that there is no room for negotiation;
- Clauses that created asymmetrical payment terms;
- A product return clause that concentrates the risks of poor sales on the supplier, not on the distributor that has the sales levers.

2. The inputs of the judgments rendered by the Court on November 20 and December 18, 2013

2.1 The conditions in which the Minister is entitled to initiate legal proceedings

On May 13, 2011, the Constitutional Council ruled on the constitutionality of the Minister's legal action against restrictive trade practices[5].

The parties that submitted to the Constitutional Council the application for a priority preliminary ruling on the issue of constitutionality complained that the disputed provisions enabled public authorities to initiate legal proceedings to request the nullification of the unlawful clauses or contracts and the refund of undue payments received in relation to a restrictive trade practice, without the party harmed by such practice being necessarily called into the dispute, which violated the rights of the defense, the adversarial principle and the harmed parties' right to remedy.

In its decision dated May 13, 2011, the Constitutional Council held that "*insofar as the parties to the contact have been informed of the initiation of such proceedings; under this reserve, the disputed provisions meet the constitutional requirements*".

Referring to this decision of the Constitutional Council, the Court recalled that harmed suppliers should be

informed by the Minister only if the action brought by the latter was an action for nullification of a contractual instrument and refund of sums.

In its judgment dated November 20, 2013, the Court noted that the Minister did not request the nullification of the contracts that contained the contentious clauses but merely the *"discontinuation of the practices in the future"* and inferred therefrom that the Minister did not interfere in the parties' contractual sphere. This released the Minister from the obligation to inform the suppliers of the proceedings, without incurring criticisms for infringing the suppliers' right to effective remedy and for restricting contractual freedom. The Court confirmed this position in its December 18, 2013 judgment.

The distinction made by the Court seems questionable. When a court is asked to rule on a request for nullification or a request for discontinuation of restrictive trade practices, its decision will, in both cases, indisputably have an impact on the parties' contractual sphere. As such, the nullification of the contract would lead the business partners to enter into a new contract and the ordered discontinuation of the restrictive trade practices would drive them to amend the contract and delete the contentious clauses.

The Court preferred to favor the efficiency of the Minister's action, without caring about the harmed suppliers whose involvement in the proceedings is not easy to manage if they do not receive an adequate official notification of the action brought by the Minister.

2.2 Bringing evidence that a business partner has been subjected to obligations that create a significant imbalance

Article L. 442-6 I §2 of the French Commercial Code penalizes the fact of "***subjecting or attempting to subject*** *a business partner to obligations that create a significant imbalance in the parties' rights and obligations".*

To sanction a restrictive trade practice, the proof that a contracting party has subjected or tried to subject its business partner to such obligations must be established.

In its judgment dated November 20, 2013, the Court specified that making available model contracts to suppliers was not criticizable *per see* and was not enough to establish the proof that a party had tried to subject the other to conditions that would have created a significant imbalance.

On the other hand, the Court noted that the absence of any amendment to the clauses set forth in the model contracts – despites the protests expressed by suppliers who had indicated their disagreement on some of the clauses and submitted addenda – demonstrated the absence of effective negotiation of the contracts and enabled to establish that the contracting party had subjected or tried to subject these contractual partners to obligations that created a significant imbalance.

In its judgment dated December 18, 2013, the Court specified that the supplier's state of subjection could be inferred from a situation of structural imbalance between a distributor that indisputably had a market power as it held 16.9% of the distribution market and suppliers that, because of this situation, could not afford to

terminate their business relationships with the distributor.

This analysis of the Court is somewhat reminiscent of the former concept of abuse of economic dependence.

2.3 Proof of the significant imbalance

– Judgment of November 20, 2013

The first clause submitted to the Court for review stipulated that the contract could be terminated in whole or in part for non-performance by the other party of one or more of its obligations eight days after the dispatch of a registered letter, in a number of enumerated cases, one of which drew the Minister's attention: *"under-performance of the product compared to the objectives fixed by common agreement between the parties and/or the results announced by the supplier*".

The Court held that this clause obviously created a significant imbalance in the distributor-supplier relationships insofar as the contract did not provide for the possibility to cure the breach before termination, that the level of seriousness of the breach was not so high, that automatic termination would occur without consideration for the length of the business relationships between the parties and that the reciprocity of the clause was mainly theoretical and did not bring any real benefit to the supplier.

It may be assumed that, in practice, this clause did not constitute an actual threat since any abusive enforcement of this clause by the distributor would have been sanctioned under Article L. 442-6 I §5 of the French Commercial Code that deals with the issue of sudden breach of established business relationships, or even under Article 1134 of the French Civil Code according to which contractual parties must perform their agreement in good faith.

The Court has, however, considered that the action brought by the Minister was of importance insofar as "*referring the matter to the judge – in case it was claimed that the clause was not applied in good faith – would not have prevented the removal [of the supplier from the list of suppliers] that would have followed the enforcement of such clause and the irreversible consequences thereof for the supplier*».

In other words, better safe than sorry.

The second clause concerned payment terms imposed on the supplier for the remuneration of the services performed by the distributor (promotion of the products through leaflets, cards and other materials).

The Court of Appeals found that this clause created a significant imbalance to the detriment of the supplier to the extent that:

- The payment term imposed on suppliers (30 days) were substantially shorter that the payment term applied by the distributor (45 days) to pay off suppliers' invoices;
- Payment terms applied to suppliers were non-derogable while the payment terms granted to the distributor were negotiable;

- The payment of monthly advances by which the suppliers advanced the costs of promotional actions that could be implemented only several months later, entailed the creation of a trade balance at the expense of supplier;
- No other clause of the contract was likely to redress such an imbalance.

The Court concluded that the contentious clauses subjected suppliers *"without offering them the possibility to really discuss this, to payment terms that necessarily tend to adversely affect their cash flow, and to contractual performance conditions that exposed them to an annihilation of the business relationships",* which caused a serious disturbance of the public economic order, thereby justifying the discontinuation of the resulting restrictive trade practices and the imposition of a 250,000 Euros civil fine on the distributor.

– Judgment dated December 18, 2013:

In first instance, the Créteil Commercial Court dismissed all the claims made by the Minister. Such claims were all brought against the *Groupement d'achat des centres distributeurs Leclerc* (group-purchasing association comprising owners of Leclerc stores) following an investigation conducted by the Directorate-General for Competition, Consumer Affairs and Prevention of Fraud in relation to 124 agreements entered into between the distributor and 58 suppliers.

The Court reversed the first instance judges' decision and considered that the framework distribution contract submitted to it for review included several clauses that created a significant imbalance to the detriment of suppliers.

The Court's reasoning applied, in particular, to the framework distribution contract clause that stipulated that the distributor's general terms of purchase prevailed over the supplier's general terms of sale.

Specifically, the Court noted that the intangibility and systematization of the general terms of purchase, which appeared in identical form in an appendix to each contract entered into by the distributors, excluded any possibility for a true negotiation.

The Court also sanctioned the clause related to the return of products damaged by clients. This clause stipulated that if the supplier offered products with tear-out premiums or promotional offers, it had to ensure that this promotional mechanism would not entail the destruction by consumers of the package or of the product in retail outlets. If this was not the case, all costs and expenses incurred in connection with the take-back or destruction of such products were to be borne by the supplier.

The Court held that this clause created a significant imbalance to the detriment of the supplier by subjecting the latter to a so-called *obligation de résultat*[6] whereas it did not have in its possession all the means necessary to perform such an obligation insofar as the marketing of the product, the choice of the location of the product, the putting of the product on the shelves and the monitoring of the clients were beyond its control.

In addition, the Court also assessed the legality of the penalty clause according to which any sum not paid on due date by the supplier would entail the payment of fixed late penalty and the application of late interests at a rate equal to three times the legal interest rate.

It found that this penalty clause created a significant imbalance to the detriment of the supplier insofar as there were no reciprocity of sanctions in case of breach since no penalty was imposed on the distributor in the event it failed to perform its contractual obligations.

The Court prohibited the distributor to apply such clauses in the future and ordered it to pay a 500,000 Euros civil fine.

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[1] Paris Court of Appeals, November 20, 2013, n°12/04791

[2] Paris Court of Appeals, December 18, 2013, n°12/00150

[3] Constitutional Council, January 13, 2011, n°2010-85 QPC

[4] Written questions with response n°29378, June 18, 2013 – National Assembly

[5] Constitutional Council, decision n° 2011-126 application for a priority preliminary ruling on the issue of constitutionality, May 13, 2013

[6] With an *obligation de résultat*, a party must fulfill a specific obligation or arrive at a specific result. With an *obligation de moyens*, the party must simply implement or use, to his/her best efforts, all necessary means in order to fulfill a specific obligation or achieve a specific result.