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Significant imbalance in the relationships between suppliers and distributors: The judge can check the contract price

The *Cour de Cassation* (French Supreme Court) recently held that a price reduction clause contractually agreed upon between a supplier and its distributor can create a significant imbalance in the rights and obligations of the parties, within the meaning of Article L. 442-6 I §2 of the French Commercial Code.

The concept of "significant imbalance", sometimes criticized for its vagueness, is addressed in a growing number of court decisions that provide a concrete illustration thereof through a factual analysis of behaviors and contractual provisions agreed upon between business partners.

The decision commented in this article is particularly noteworthy because it recalls that, as per the terms of the above-mentioned Article, the judge is empowered to check the price set by the parties.

Article L. 442-6 I of the French Commercial Code includes a list of prohibited and punishable practices that restrict competition. Article L. 442-6 I §2 refers to 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*".

1. **Reminder of the concept of significant imbalance in the rights and obligations of the parties**

Significant imbalance is a concept that comes from consumer law (Article L. 212-1 of the French Consumer Code). This is, in particular, what has led the Constitutional Council to rule that Article L. 442-6 I §2, despite it vagueness, was compliant with 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) as the scope of this concept has already been specified by consumer law related case-law[1].

Just like French consumer law, the above Article is intended to protect the weak against the strong, but this time in the relationships between business partners, in particular in the large retail sector[2].

As such, enforcement of Article L. 442-6 I §2 – that concerns any contractual obligation (provision of services, sales, etc.) – requires an assessment *in concreto* of the contentious contractual clauses in order to determine whether there exists a subjection or an attempted subjection to a significant imbalance.

In general, it follows from applicable case-law that non-reciprocal, potestative, disproportionate, vague and non-negotiable clauses as well as clauses that are not justified by any imperative are likely to characterize the existence of a significant imbalance.

For example, the following clauses have been held constitutive of a significant imbalance:

- A clause that authorized the unilateral termination of the contract by the distributor upon the expiry of an eight-day period following the dispatch of a registered letter, return receipt requested, to the supplier in relation to the under-performance of a product compared to the objectives that had been set by the parties, because such registered letter did not provide the supplier with the opportunity to remediate the problem, even if such problem was very minor, before the termination, and because the reciprocity of the clause was only theoretical[3];
- The penalty clause for late payments imposed only on the supplier, whereas the contract did not provide for any penalty to sanction contractual breaches by the distributor [4];
- The clause concerning unsold products, according to which (i) the supplier had the obligation to take back all of the stock of unsold products at the end of the financial year or at the end of the seasonal marketing period, and (ii) a credit note was to be issued to the distributor in this respect[5].

However, the *Cour de Cassation* also specified that the characterization of a significant imbalance must rely on a concrete and global analysis of the contract that governs the relationships between the parties, not only on a clause-by-clause analysis[6].

As such, wherever a clause is deemed imbalanced, it is up to the economically stronger party to demonstrate the existence of provisions that have the effect of rebalancing the contract.

2. **Analysis of the decision handed down by the *Cour de cassation* on January 25, 2017**

In the commented decision[7], the purchasing organization of a group operating in the large retail sector challenged the appellate judgment entered against it on the basis of Article L. 442-6 I §2 of the French

Commercial Code, following a claim brought by the Minister of Economy. The group's purchasing organization was blamed for having obtained a price reduction from 46 suppliers in the form of a year-end rebate ("YER") provided for in 118 framework contracts that had been concluded with said suppliers in 2009 and 2010.

First of all, the *Cour de cassation* recalled that with respect to the relationships between a supplier and a distributor, the existence of a significant imbalance in the rights and obligations of the parties must be assessed on the basis of the written agreement referred to in Article L. 441-7 of the French Commercial Code, agreement that must define *inter alia* the terms and conditions governing the sale of the products or the provision of the services, including any price reductions agreed upon following business negotiations between the parties.

In the case at hand, the framework contracts reviewed by the judge included an annex that stipulated that the contentious YER was part of the terms and conditions governing the sale of products. As such, Article L. 442-6 I §2 of the French Commercial code was indeed applicable.

Secondly, the *Cour de Cassation* confirmed that the significant imbalance may result from the inadequacy of the price to the product sold, contrary to the provisions set forth in Article L. 212-1 of the French Consumer Code.

Indeed, Article L. 212-1 §3 of the French Consumer Code stipulates that the assessment of the abusive nature of contractual terms does not involve "*either the definition of the main purpose of the contract* ***nor the adequacy of the price of, or remuneration for, the goods being sold or the service being offered****, provided that the terms are written in a clear and comprehensible manner*".

Yet, this restriction is not restated in Article L. 442-6 I §2 of the French Commercial Code. The Group's purchasing organization did try, however, to rely on it, claiming that the Constitutional Council had held that these provisions were compliant with the principle of legality of offenses and punishments only to the extent that the concept of significant imbalance had already been specified by court decisions issued on the basis of Article L. 212-1 of the French Consumer Code[8].

This argumentation was dismissed by the *Cour de Cassation* that confirmed that the judge may, under Article L. 442-6 I §2 of the French Commercial Code, lawfully check the price set between a supplier and a distributor as well as the adequacy of such price to the value of the product that is sold or the service that is provided, insofar as said price was not determined by free negotiation and characterizes the existence of a significant imbalance in the rights and obligations of the parties.

Lastly, on the contentious contractual terms, they provided for the payment of a YER:

– either in consideration of indeterminate sales or sales targets amounting approximately to 50% of the revenue achieved in the preceding year and during the year when such YER was due;

– without any consideration.

The *Cour de Cassation* also noted that:

- The suppliers had paid a YER while the distributor had not made any commitment or actual commitment towards them,
- The advance payments on the YER paid by the suppliers were calculated on the basis of sales targets that were effectively close to the achieved revenue and much higher than the revenue that the purchasing organization had committed to achieve to obtain the price reduction,
- The advance payments on the YER were paid by the suppliers before the price of the product was paid by the purchasing organization, which means that the latter benefited from a cash advance at the expense of the suppliers.

Lastly, the *Cour de Cassation* pointed out that the purchasing organization did not invoke any other contractual provisions that would rebalance the framework contracts.

In these circumstances, the *Cour de Cassation* upheld the judgment of the Court of Appeals that had ruled that the implementation of the YER provided for by the aforementioned contractual terms created a significant imbalance in the rights and obligations of the parties, within the meaning of Article L. 442-6 I §2 of the French Commercial Code.

[1] Constitutional Council, Decision n°2010-85 QPC of January 13, 2011

[2] It should be noted that the concept of significant imbalance in the rights and obligations of the parties has been introduced in the French Civil Code following Ordinance n°2016-131 dated February 10, 2016 for the reform of French contract law. A such, Article 1171 of the French Civil Code henceforth stipulates that any clause that creates a significant imbalance between the rights and obligations of the contractual parties shall be deemed unwritten [i.e. ineffective] but limits the scope of such clause to so-called ""standard-form" contracts and, just like under French distribution law, specifies that the assessment of the significant imbalance concerns neither the main purpose of the contract, nor the adequacy of the price to the service performed.

[3] Commercial Chamber of the *Cour de Cassation*, March 3, 2015, n°14-10907

[4] Commercial Chamber of the *Cour de Cassation*, May 27, 2015, n°14-11387

[5] Commercial Chamber of the *Cour de Cassation*, September 29, 2015, n°13-25043

[6] Commercial Chamber of the *Cour de Cassation*, March 3, 2015, n°13-27525 and n°14-10907

[7] Commercial Chamber of the *Cour de Cassation*, January 25, 2017, n°15-23547

[8] Constitutional Council, Decision n°2010-85 QPC of January 13, 2011

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