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**Best Practices in International Distribution Contract Drafting:  
A Guide to Key Contract Provisions  
Viewed from Europe (especially France)**

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## 1. INTRODUCTION

In contrast to some contract types regulated by French law, such as sale contracts (*contrats de vente*),<sup>2</sup> the precise content of distribution contracts exclusively depends on the parties' agreement. However, this does not mean that the parties are completely free to arrange their contractual relationship as numerous constraints have to be kept in mind. The drafting of the distribution contract is thus of particular importance.

If the laws on distribution have their source in civil law, they have been influenced to a large extent by competition law. In Europe, to a greater degree than is the case in the United States, vertical distribution contracts have to comply with EU antitrust provisions. While drafting a distribution contract which might affect the European market, a lawyer should therefore always be aware of European and domestic competition law which might be applicable in the specific case. European (and national) provisions on agency constitute another legal constraint that lawyers have to keep in mind.

In the following I present the main issues which have to be observed when drafting the key distribution contract provisions which have to comply with European laws.

## 2. COMPETITION LAW - OVERVIEW

### 2.1 European antitrust law

#### 2.1.1 **Applicability of European antitrust law**

In order for European antitrust rules to be applicable, the agreement or practice must be capable of appreciably affecting trade between Member States. In case of vertical agreements European competition authorities and courts consider not only the agreement at stake, but also the cumulative effect of parallel networks of similar agreements. The European Commission considers that there is a presumption that an agreement is not capable of appreciably affecting trade between Member States if the aggregate market share of the parties on any relevant market within the European Community affected by the agreement does not exceed 5% and, in the case of vertical agreements, the aggregate annual Community turnover of the supplier in the products covered by the agreement does not exceed EUR 40 million.<sup>3</sup>

If the supplier and the distributor are from different Member States, the agreement is almost automatically capable of affecting trade between Member States, as soon as the abovementioned thresholds are met. However, in the area of international distribution, one of the parties is frequently registered in a country outside of the European Union. This does not preclude the application of European antitrust law, as these provisions apply irrespectively of where the undertakings are located or where the agreement has been concluded, provided that

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<sup>2</sup> Regulated by articles 1582 to 1701 of the French civil code.

<sup>3</sup> Commission Guidelines on the effect on trade concept contained in Articles 81 and 82 of the Treaty.

the agreement or practice is either implemented inside the European Community<sup>4</sup>, or produces effects inside the European Community.

Additionally, trade between Member States may be affected if the distribution agreement prevents re-imports into the EC, for example if a Community supplier imposes on a third country distributor a prohibition of making any sales in any territory other than the contractual territory, including the territory of the Community. However, the criteria used by the European Court of Justice in order to evaluate whether trade between Member States is affected in such a case are not likely to be easily fulfilled.<sup>5</sup>

Whenever EU antitrust law is applicable, it has to be honoured by national competition authorities and courts, to the same extent as domestic competition law if the latter is also applicable. The application of national competition law may not lead to the prohibition of agreements that are legal according to EU antitrust law. However, Member States may apply stricter domestic laws on unilateral conduct engaged in by undertakings.<sup>6</sup>

The key provisions of European antitrust law are articles 81 and 82 of the European Community Treaty (the “ECT”), prohibiting respectively restrictive agreements and abuse of a dominant position.

### **2.1.2 Restrictive agreements (Article 81 (1) ECT)**

Article 81 (1) ECT prohibits “all agreements between undertakings...which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market.”

In order for agreements to be considered contrary to article 81 (1) ECT, the agreement must have been concluded between independent undertakings, i.e. article 81 (1) ECT is not applicable if one of the parties is an agent of the other. Neither does it apply to inter-group agreements.<sup>7</sup>

Typically, article 81 (1) ECT covers horizontal agreements between competitors. However, since the judgement of the European Court of Justice in *Grundig and Consten*<sup>8</sup>, vertical agreements and thus distribution contracts are also potentially covered by this provision.

### **2.1.3 Abuse of a dominant market position (Article 82 ECT)**

Article 82 ECT prohibits the abuse by a dominant undertaking (or a number of jointly dominant undertakings) of their market strength.

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<sup>4</sup> Judgment of the European Court of Justice of 27 September 1988, Joined Cases C-89/85 and others, *Ahlström Osakeyhtiö and others v Commission of the European Communities*.

<sup>5</sup> Judgment of the European Court of Justice of 28 April 1998, Case C-306/96, *Javico International and Javico AG v Yves Saint Laurent Parfums SA*.

<sup>6</sup> Article 3 of Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty.

<sup>7</sup> Judgment of the European Court of Justice of 24 October 1996, Case C-73/95P, *Viho Europe BV v Commission of the European Communities*.

<sup>8</sup> Judgment of the European Court of Justice of 13 July 1966, Joined Cases 56/64 and 58/64, *Établissements Consten S.à.R.L. and Grundig-Verkaufs-GmbH v Commission of the European Economic Community*.

In order for article 82 ECT to apply, the undertaking has to be dominant in the relevant market. This is the case not only if the company is a monopoly, but can be true also if the market share is in excess of 40% or even of a lower threshold. Several factors are examined (e.g. position of competitors) in order to determine whether the entity is in a position to behave “to an appreciable extent independently of its competitors, customers and ultimately of its consumers”.<sup>9</sup>

As far as distribution contracts are concerned, abuse can take the form of imposing exclusive purchasing and supply obligations, excessive or discriminatory pricing, loyalty-inducing rebates, *de facto* control of distributors’ prices, etc.

#### **2.1.4 Consequences of infringement of EU antitrust rules**

An agreement caught by article 81 (1) ECT and not exempted is not enforceable. The offending part or the entire agreement (if the offending agreement cannot meaningfully be severed) will be void according to article 81 (2) ECT.

Furthermore, an infringement may lead to penalties imposed by the European Commission or by a national competition authority of up to 10% of the undertaking’s worldwide turnover in the preceding business year.<sup>10</sup>

Moreover, third parties adversely affected by an anticompetitive agreement may sue for damages for any loss which they can establish they have suffered as a result of the infringement. The victim asking for damages may even be the other party to the contract.<sup>11</sup> However, according to the European Court of Justice, Community law does not preclude a rule of national law barring a party to a contract liable for restricting or distorting competition from relying on its own unlawful actions to obtain damages where it is established that that party bears significant responsibility for the distortion of competition.

## **2.2 French competition law**

French law prohibits, in addition to the practices already caught by EU (and French) antitrust law, so-called restrictive practices, like for example resale with loss (*revente à perte*), non-communication of general terms and conditions and price lists (transparency obligation), imposing obligations on a contracting party which create a mismatch in the rights and obligations of the parties, abrupt termination of a contractual relationship without respecting an appropriate notice period, or the threat to terminate an agreement in order to obtain benefits which are obviously abusive.<sup>12</sup>

The ECT allows Member States to impose stricter provisions that prohibit abuse. Article L.420-2 (2) of the French commercial code prohibits abuse of “economic dependence”.

The drafter of a distribution agreement should keep in mind these provisions, some of them being subject to criminal sanction.

<sup>9</sup> Judgment of the European Court of Justice of 14 February 1978, Case 27/76, United Brands Company and United Brands Continentaal BV v Commission of the European Communities.

<sup>10</sup> Article 23 (2) of Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty.

<sup>11</sup> Judgment of the European Court of Justice of 20 September 2001, Case C-453/99, Courage Ltd v Bernard Crehan.

<sup>12</sup> Articles L.442-1 to L.442-10 of the French commercial code.

### **3. THE DIFFERENT RIGHTS AND OBLIGATIONS OF THE PARTIES**

The essence of a distribution contract is usually that the distributor resells and promotes the supplier's products on a regular basis. Two areas are typically essential for the parties and likely to generate conflicts: the freedom of each party to decide where and to whom it may sell the products and the determination of the price to be paid for the products.

#### **3.1 Choice of the customer**

The parties' freedom to choose their contractual partner (the purchaser of their goods or services or the seller from whom they buy goods or services) depends on the type of distribution contract to be concluded. For instance, in a selective distribution contract, the supplier may impose other restrictions on the distributor than in an exclusive distribution contract.

##### **3.1.1 Exclusive distribution contract (*accords de distribution exclusive*)**

The supplier undertakes not to supply its products to other distributors in a given territory. The supplier may reserve the right to perform direct sales to customers in that territory. In the case of exclusive supply obligations, the supplier undertakes to sell its products only to one distributor.

##### **3.1.2 Non-exclusive distribution contract (*accord de distribution non-exclusive*).**

The supplier reserves the right to appoint other distributors in the territory and to supply its products to them.

##### **3.1.3 Exclusive purchase contract (*accord d'achat exclusif*)**

The distributor undertakes to buy products only from one single supplier. This type of contract is treated in section 5 (Non-compete / restrictive covenants).

##### **3.1.4 Selective distribution contract (*accord de distribution sélective*)**

In a selective distribution system, the supplier undertakes to sell the contract goods or services only to distributors selected on the basis of specified criteria (qualitative and/or quantitative). The distributors undertake not to sell such goods or services to unauthorized distributors. Selective distribution is commonplace and admitted for goods which require a high level of expertise on the part of the distributor, such as technical and luxury products.

These categories can be combined. For instance, the supplier may be bound by an exclusivity provision as far as the distributor's territory is concerned, the distributor being obliged to buy its products exclusively from the supplier.

### 3.2 Choice of the customer - Impact of EU antitrust law

The restriction of commercial freedom of the parties to (re-)sell the products *a priori* infringes article 81 (1) ECT as it restricts competition.

However, it is still possible to avoid the consequences of infringement if the agreement meets the criteria for exemption posed by article 81 (3) ECT, i.e. the agreement must contribute to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, without imposing disproportionate restrictions on the undertakings concerned or giving the concerned undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

In order to facilitate this assessment, the Commission has adopted a number of block exemption regulations. These set out conditions under which a category of agreement will be presumed exempt. Each regulation contains a list of those restrictions on competition that are permitted for the appropriate type of agreement, of those restrictions that are prohibited and prevent the exemption from applying, and of those provisions not likely to be enforceable but not endangering the rest of the agreement. If an agreement meets all the requirements of the applicable regulation, it will automatically be exempt.

Distribution contracts are thus specifically drafted in order to fit within the block exemption for vertical agreements (“**Exemption Regulation**”).<sup>13</sup> For the motor vehicle sector, a special exemption regulation exists whose provisions differ from those of the general Exemption Regulation.<sup>14</sup>

In order for an agreement to fall *prima facie* under the Exemption Regulation, the supplier’s market share on the relevant market on which it sells the contract goods or services must not exceed 30%. If the agreement contains an exclusive supply obligation (i.e. any direct or indirect obligation causing the supplier to sell the goods or services specified in the agreement only to one buyer inside the Community), the benefit of the Exemption Regulation is only available if the buyer’s market share on the purchasing market does not exceed 30%.<sup>15</sup> If this threshold is exceeded, the agreement is not covered by the Exemption Regulation, but has to be considered specifically, with regard to article 81 (3) ECT and the Commission’s Guidelines on Vertical Restraints.<sup>16</sup>

Once a distribution contract is covered by the Exemption Regulation, its clauses still have to be examined, as not all clauses are permitted. If the agreement contains hardcore restrictions, the Exemption Regulation does not apply to the agreement, which has then to be examined with regard to article 81 (3) ECT. Although it is theoretically possible that an agreement containing hardcore restrictions is considered as exempted on the basis of article 81 (3) ECT, this is not likely. Other clauses are unacceptable in themselves and are not enforceable, but do not prevent the other provisions of the distribution contract from enjoying the exemption.

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<sup>13</sup> Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81 (3) of the Treaty to categories of vertical agreements and concerted practices.

<sup>14</sup> Commission Regulation (EC) No 1400/2002 of 31 July 2002 on the application of Article 81 (3) of the Treaty to categories of vertical agreements and concerted practices in the motor vehicle sector.

<sup>15</sup> Article 3 of the Exemption Regulation.

<sup>16</sup> Guidelines on Vertical Restraints, 2000/C 291/01.

According to the Exemption Regulation, the restriction of the territory into which, or of the customers to whom, the buyer may sell the contract goods or services is in principle a hardcore restriction, which means that an agreement containing such a clause would not be exempt, even if the market share of the supplier did not exceed 30%.

However, some restrictions on territory and customers are permitted, i.e. do not prevent a distribution contract from being exempted:

- **The restriction of active sales into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer, where such a restriction does not limit sales by the customers of the buyer.**

In case of an exclusive distribution contract, the supplier can thus not forbid the distributor to passively sell the products to customers outside of its territory.

According to the Guidelines on Vertical Restraints, “active” sales mean actively approaching individual customers or a specific customer group inside another distributor’s territory by for instance direct mail or visits, or through advertisement specifically targeted at the customer group in question. “Passive” sales mean responding to unsolicited requests from individual customers.

In order to clarify the meaning of passive and active sales as far as distribution over the Internet is concerned, the draft Guidelines on Vertical Restraints<sup>17</sup> include examples of forbidden restrictions on passive sales, for example requiring distributors:

- to prevent customers in another territory from viewing their website or to automatically re-route them,
- to terminate internet transactions if credit card details reveal an address outside the distributor’s territory,
- to limit the proportion of overall sales made over the Internet, or
- to pay a higher price for products intended to be resold online.

- **The restriction of sales to end users by a buyer operating at the wholesale level of trade.**
- **The restriction of sales to unauthorized distributors by the members of a selective distribution system.**

However, the restriction of active or passive sales to end users by members of a selective distribution system is a hardcore restriction which prevents the distribution contract from being exempted on the basis of the Exemption Regulation. The same is true for restrictions of cross-supplies between distributors within a selective distribution system, including between distributors at a different level of trade.

- **The restriction of the buyer's ability to sell components, supplied for the purposes of incorporation, to customers who would use them to manufacture the same type of goods as those produced by the supplier.**

Thus, if the market share of the supplier does not exceed 30%, the restrictions mentioned above are permitted. If the supplier's market share exceeds 30%, such restrictions are not necessarily forbidden, but have to be evaluated with reference to article 81 (3) ECT and the Guidelines on Vertical Restraints. The same is true for agreements where the supplier's market share does not exceed 30%, but which contain hardcore restrictions. It is unlikely that distributions contracts containing hardcore restrictions will be exempted on the basis of article 81 (3) ECT, but not impossible, if the parties can prove that their distribution system leads to efficiencies.

### **3.3 Distribution over the Internet**

Suppliers might be reluctant to allow their distributors to use the Internet for the resale of their products, as the Internet makes it more difficult to restrict the distributors' freedom to choose their customers. However, the European Commission is favorable to the use of the Internet as a means to foster the integration of the Common Market. Accordingly, the Guidelines on Vertical Restraints specify that every distributor must be free to use the Internet to advertise or to sell products. Use of the Internet can be prohibited only in so far as it would lead to active selling into other distributors' exclusive territories or customer groups. The mere fact of the distributor's website being accessible from the other territories results from the technology and cannot be considered as active sales. The draft Guidelines on Vertical Restraints now specify what should be considered as passive sales over the Internet (see above point 3.1.1.a).

The supplier may require quality standards for the Internet site used to resell its goods, in particular in a selective distribution system, just as the supplier may require quality standards for a shop or for advertising and promotion in general. An outright ban on Internet selling is only possible if there is an objective justification, e.g. if the products are not suitable for distribution over the internet like for instance pharmaceuticals. The criteria allowing to refuse Internet selling must be comparable to those for sales from a traditional retail outlet (i.e. need to maintain the brand image and reputation of the products) and must be applied indiscriminately.

In 2006, the French Competition Council stated that the absence, in the framework distribution contract of a French manufacturer of watches, of rules applicable to online sales, in circumstances where some individual authorizations had been granted to some approved customer stores was anticompetitive. The manufacturer modified the contract so that current and future distributors were granted the possibility to sell over the Internet. However, the Council accepted the possibility for the supplier to refuse access to its selective distribution network for companies selling exclusively over the Internet.<sup>18</sup>

Thus, the supplier's possibility to restrict the distributor's right to sell outside of a given territory or to sell to customers of its choice is somewhat limited.

### **3.4 Pricing**

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<sup>18</sup> Decision No 06-D-24 of the French Competition Council of 24 July 2006, Festina France.



### 3.4.1 Resale prices

According to the Exemption Regulation, resale price maintenance, i.e. the restriction of the buyer's ability to determine its sale price is a hardcore restriction. However, the supplier may impose a maximum sale price or recommend a sale price, provided that this does not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties.

Therefore, a distribution contract allowing the supplier to determine the resale price applied by the distributor is unlikely to be valid. However, an exemption on the basis of article 81 (3) ECT is not impossible, as such policies can bring about efficiencies, such as providing distributors with the means to increase promotional efforts and to successfully enter a new market.<sup>19</sup>

Thus the supplier's freedom to reserve rights on resale prices is restricted.

### 3.4.2 Sale prices

According to French case law, the prices paid by the distributor in order to buy the suppliers' products do not have to be precisely determined in the distribution contract, but French courts control that there is no abuse in the subsequent determination of the price.<sup>20</sup> For that reason the parties should insert a clause making the subsequent sale prices objectively determinable, e.g. provide that they will be determined by a third party. In practice, sale prices are often determined by a reference to the supplier's current price list, which is annexed to the distribution contract and which the supplier is authorised to modify unilaterally. This is comfortable for the supplier, but does not preclude the contract from being attacked for abuse in subsequent price fixing. Therefore it may be advisable to insert restrictions on the supplier's ability to modify the price list, like for example timely constraints (e.g. modification possibility limited to once a year).

The pricing policy of an undertaking in a dominant market position might be found contrary to article 82 ECT, abuses consisting for example of discriminatory pricing<sup>21</sup>, excessive pricing, bundling or fidelity pricing.

Thus, EU antitrust law restricts the supplier's freedom to reserve substantial rights in areas such as pricing and choice of customers.

## 3.5 The distinction between agency and distribution

A qualification as agency according to the applicable civil law does not necessarily immunize the agreement against antitrust law, which has its own definition of agency. According to the definition of EU antitrust law, an agent is a legal or physical person who is vested with the power to negotiate and/or conclude contracts on behalf of another person (the principal), either in the agent's own name or in the name of the principal, for the

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<sup>19</sup> This possibility of exemption is only mentioned by the draft Guidelines on Vertical Restraints.

<sup>20</sup> Lamy Droit Economique 2013, point 4074.

<sup>21</sup> Judgment of the Court of First Instance of 7 October 1999, Case T-228/97, Irish Sugar plc v Commission of the European Communities.

- purchase of goods or services by the principal, or
- sale of goods or services supplied by the principal.

The more rights the supplier reserves, the more likely it is that the relationship is qualified as an agency.

In order to qualify a given relationship, the European Commission and Courts examine to what extent the distributor/agent assumes the financial or commercial risk in relation to the sold products/services. The Commission's Guidelines on Vertical Restraints contain a section on agency and provide a non-exhaustive list of the types of risk an agent should not bear. Thus, if the agent does not gain ownership in the principal's goods and does not bear the risk either for assuming the distribution costs (e.g. transporting), or for sales promotion, maintaining stocks of the goods, operation of an after-sales, repair or warranty service, product liability to third parties or for customers' non-performance, the qualification as agent is justified.

The consequence of the qualification of a contract as agency agreement is that article 81 ECT is not applicable, as it requires an agreement between independent undertakings. Agency agreements do thus not have to be specifically drafted in order to fit within the Exemption Regulation.

Whereas this consequence might be beneficial to the supplier, the other consequences would be detrimental for it, as commercial agents enjoy a protected status in the EU (in particular the principal is obliged to pay indemnification or compensation upon termination of the agreement, see below point 4.3.2.a).

### **3.6 Treatment of new products**

In general, the distributed products are defined by a reference to a products list annexed to the distribution contract. In principle the distribution contract can only be modified by the parties' mutual agreement. However, it is often provided that the supplier may unilaterally remove products from and add new products to the products list. If the clause is formulated that way, the distribution contract runs the risk of being declared void, as the supplier's obligation would not be determinable, but arbitrary. That is why it is recommended to attach a list with products that might potentially be added. The parties should also insert a clause specifying in what circumstances new products can be added, e.g. extension of the supplier's activity, change of fashion, technical improvement etc.<sup>22</sup> It may also be provided that new products are added by mutual agreement of the parties.

If however the type of product completely changes, a new contract should be concluded, at least if the different nature of the product requires a modification of the other provisions of the agreement. For instance, a selective distribution system might be justified in case of sophisticated products (luxury, technical products), but not in case of products the resale of which does not require any special expertise.

## **4. TERMINATION**

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<sup>22</sup> Lamy Droit Economique 2013, point 4485.

#### **4.1 Restrictions on the parties' right to terminate the relationship**

Under French law, the sudden breaking of an established commercial relationship without respecting a notice period which takes into account the duration of the relationship makes the author liable to the other party having suffered damage as a result of the abrupt termination of the contract. In case of an act of God or non-performance by the other party of its obligations, no notice period has to be respected.<sup>23</sup> “Established commercial relationship” refers to contracts which have been concluded for an indefinite term, but also concerns non-formalized punctual but constant forms of cooperation and also contracts concluded for a definite term. French courts consider this provision as applicable if the termination of the contract takes place in France, even if the law chosen by the parties is not the French law.<sup>24</sup>

Only the damage resulting from the sudden character of the termination can be repaired, as opposed to the damage resulting from the termination as such.

Apart from the necessity to respect a notice period, the party having the right to terminate the distribution contract must not use its right in an abusive manner, the concept of abuse being interpreted by French case law.

In case of agreements that are performed over time, like distribution contracts, French law distinguishes agreements concluded for an indefinite term and those concluded for a definite term. Agreements concluded for an indefinite term can in general be terminated unilaterally by each party by observing a notice period.

However, distribution contracts are in most cases concluded for a definite term which may in some cases be renewed by the parties either explicitly or tacitly. It should be noted that EU antitrust law imposes a maximum duration of five years for non-compete clauses. Thus if a distribution contract contains such a non-compete clause, the parties should pay attention that its term does not exceed five years (see below point 5.1.1). In the case of a definite term, the agreement cannot be terminated before the end of that term, except in case of non-execution or other events, which the parties may contractually determine.

It is important that the parties include a provision allowing each party to terminate the contract in certain circumstances. In fact, without such a provision, the party wishing to terminate the contract would have to request the termination in court. Article 1184 of the French civil code provides that if a party to a contract does not perform its obligations, the other party has the possibility to request the termination of the agreement in court (principle of judicial termination). It is however recognized that the parties can provide in their contract that it can be terminated by each of the parties unilaterally, without any court decision. In case of special circumstances like a serious default of one of the parties causing irreparable damage to the other, the contract can be terminated unilaterally even without a termination clause.

#### **4.2 Termination clause and grounds for termination**

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<sup>23</sup> Article L.442-6 (5) of the French commercial code.

<sup>24</sup> Lamy Droit Economique 2013, point 4033.

A termination clause may allow each party to unilaterally terminate the distribution contract without observing a notice period, having to justify the decision or having to pay an indemnity.

In order to draft the clause concerning the events allowing for termination of the contract, a general provision may be included to the effect that if a party does not meet its obligations under the contract and does not remedy to this infringement within a certain time frame, the other party is entitled to terminate the contract. Then specific events where it is important for the parties that they trigger termination should be enumerated, e.g.:

As far as the supplier's rights are concerned:

- The distributor sells competing products with the ones of the supplier in violation of the contract.
- The distributor does not meet its contractual purchasing objectives.
- The distributor infringes the supplier's intellectual property rights.
- The distributor does not obtain an approval necessary for the distribution of the products, etc.

As far as the distributor's rights are concerned:

- The supplier does not respect its obligations with respect to the supply of the contractual goods or services in sufficient quality and quantity.
- The supplier sells its products to clients situated in the distributor's territory, against its promise.
- The supplier transfers any of the trade marks concerning the distributed products to a third person, etc.

As far as both parties' rights are concerned:

- A party becomes insolvent.<sup>25</sup>
- There is a change in the control of one of the parties, etc.

Both the supplier and the distributor may want to include events in the distribution contract which would allow them to terminate the contract before the end of the term, without observing a notice period. It depends on every single case which termination grounds are most important for the parties. In practice the supplier is often in a stronger position than the distributor and may thus impose termination grounds favorable to itself.

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<sup>25</sup> The effect of this clause might be frustrated by article L.622-13 of the French commercial code which provides that notwithstanding any contractual provision, no termination of an on-going contract may be the result of the opening of insolvency proceedings alone.

It cannot be excluded however that a French judge may disregard a termination clause if he considers that the party having terminated the contract has not been loyal and used its termination right abusively.<sup>26</sup>

If a distributor considers that the termination of the distribution contract by the supplier was unjust and that he suffered damage, he may of course sue the supplier in court and bring an action for damages. However, the parties may include in their distribution contract a penalty clause determining an indemnity which would be due by the author of a sudden or abusive termination of the contract. French courts have the power to revise these penalty clauses if they are obviously excessive or insignificant.<sup>27</sup>

### **4.3 Consequences of termination**

On termination of any distribution contract the consequences will be determined mainly by the terms of the contract, but possibly also be affected by mandatory rules of law such as competition laws or laws protecting the intermediary.

#### **4.3.1 Contractual consequences**

The supplier may want to provide in the distribution contract that none of the parties can claim indemnity from the other due to the termination of the contract in accordance with its terms. This clause might be ineffective if the distribution contract is re-qualified into an agency contract (see point 4.3.2 below).

The supplier should make sure in the contract that the distributor informs its clients at the termination of the contract about the fact that it is no longer the exclusive distributor of the products in the territory and that it stops using the supplier's trade mark and other rights or denominations connected to the distributed products.

The parties should agree upon the fate of the products remaining in the distributor's possession (defective or not) as well as upon the destruction of advertising objects in the distributor's possession.

The modalities of the settlement of outstanding debts should also be provided for in the clause concerning the consequences of termination of the distribution contract.

#### **4.3.2 Legal consequences**

In most Member States, distributors do not enjoy the same protection as commercial agents who are in a comfortable position due to laws which regulate their rights and obligations and which allow them to receive a compensatory payment from the principal on termination of their contract.

##### **(a) Commercial agents**

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<sup>26</sup> Lamy Droit Economique 2013, point 4248.

<sup>27</sup> Lamy Droit Economique 2013, point 4291.

Unlike distributors, commercial agents enjoy special protection by EU law. Council Directive 86/653/EEC of 18 December 1986 on the coordination of the laws of the Member States relating to self-employed commercial agents (the “**Commercial Agents Directive**”) sets out a number of significant rights for commercial agents, which it defines as self-employed intermediaries who have continuing authority to negotiate the sale or the purchase of goods on behalf of another person (the principal), or to negotiate and conclude such transactions on behalf of and in the name of that principal.<sup>28</sup> In some Member States, services are also concerned.<sup>29</sup>

The Commercial Agents Directive applies to self-employed<sup>30</sup> commercial agents who can be individuals or corporations. The protections of the Commercial Agents Directive are mainly:

- Right to a written agreement.
- Rules on entitlement to commission and on due date for payment of commission.
- Rights to commission after termination in respect of transactions generated by the agent.
- Minimum notice period.
- Rights to be indemnified or compensated in case of termination.

The most contentious right is the agent’s right to indemnification or compensation upon termination of the agreement. Under article 17 of the Commercial Agents Directive, Member States have the choice whether they want to adopt the compensation concept or the indemnity concept.

Compensation refers to damage suffered by the agent due to the termination of the agency agreement. It is irrespective of contractual damages.<sup>31</sup> The agent is entitled to be compensated for damage which is deemed to have occurred in particular where termination takes place in circumstances depriving the agent of commission which proper performance of the contract would have procured him, whilst providing the principal with substantial benefits linked to the agent’s activities. Further, an agent is entitled to compensation where termination prevents the agent from amortizing costs and expenses incurred for the performance of the agency contract on the principal’s advice.<sup>32</sup>

Indemnity is due if (1) the principal continues to derive substantial benefits from the agent’s activity who has brought new customers or increased the volume of business with existing customers, and (2) the payment of this indemnity is equitable having regard to all circumstances and, in particular, the commission lost by the agent on the business transacted with such customers.<sup>33</sup>

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<sup>28</sup> Article 1.2 of the Commercial Agents Directive.

<sup>29</sup> Michael J. Dean: International Distribution Overview of Relevant Distribution Laws: Europe. March 2007. Section 7.2.

<sup>30</sup> “Self-employed” means that the agent is not an employee.

<sup>31</sup> Michael J. Dean: International Distribution Overview of Relevant Distribution Laws: Europe. March 2007. Section 7.4.

<sup>32</sup> Article 17.3 of the Commercial Agents Directive.

<sup>33</sup> Article 17.2 (a) of the Commercial Agents Directive.

Indemnity is capped at one year's commission averaged over the preceding five years, or, if less, the duration of the agreement.<sup>34</sup> Indemnity is justified by the goodwill created by the agent. If no goodwill has been created, no indemnity needs to be paid.

In a recent decision<sup>35</sup>, the European Court of Justice has clarified the articulation between the different criteria used for determining the indemnity. A German court had asked whether it was possible to limit the agent's indemnity by the amount of commission lost as a result of the termination of the agency contract, even though the benefits which the principal continues to derive are of a higher monetary value. The Court states in its judgment that the discretion that Member States have to adjust the indemnity in order to make it equitable (second criterion) cannot be construed to the effect that the indemnity can only be adjusted downwards. Therefore it is not possible to automatically limit the indemnity by the amount of commission lost as a result of the termination of the agency contract, the Commercial Agents Directive seeking in particular to protect commercial agents in their relations with their principals.

While Germany has chosen the indemnity concept,<sup>36</sup> France has transposed the Commercial Agents Directive by introducing the compensation concept.<sup>37</sup> Under French case law, the level of compensation is fixed as the global sum of the last two years' commission calculated over the average of the last three years of the agency contract, courts being able to award a different sum if there is evidence that the actual loss was in fact greater or smaller, for example if the agent's activity has actually not led to the conclusion of new contracts or if an agent takes clients with him.<sup>38</sup> French courts have specified that if an agency contract is terminated by the principal before the end of the contractual term, the agent is entitled to compensation for the damage resulting from the loss of revenue until the end of the contractual term plus compensation for the damage resulting from the loss of revenue for the future (corresponding to the compensation resulting indirectly from the Commercial Agents Directive).<sup>39</sup>

Neither compensation nor indemnity is payable (1) where the principal has terminated the contract because of default attributable to the agent which could justify immediate termination of the contract under national law, (2) where the agent has terminated the contract, unless such termination is justified by circumstances attributable to the principal, or (3) where the agent, with consent of the principal, assigns its rights and duties under the contract to another person.<sup>40</sup> The French *Cour de Cassation* has held that the burden of proof is on the principal to prove that the agent was in breach if the agent alleges that the failure to meet contractual targets was due to economic stagnation or competition from the principal.<sup>41</sup>

The parties to an agency contract may not derogate from the Commercial Agents Directive's provisions on indemnity and compensation.<sup>42</sup>

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<sup>34</sup> Article 17.2 (b) of the Commercial Agents Directive.

<sup>35</sup> Judgment of the European Court of Justice of 26 March 2009, Case C-348/07, Turgay Semen v Deutsche Tamoil GmbH.

<sup>36</sup> Article 89b of the German commercial code.

<sup>37</sup> Article L.134-12 of the French commercial code.

<sup>38</sup> Lamy Droit Economique 2013, point 4097.

<sup>39</sup> Lamy Droit Economique 2013, point 4098.

<sup>40</sup> Article 18 of the Commercial Agents Directive.

<sup>41</sup> Judgment of the *Cour de cassation, Chambre Commerciale*, of 13 November 1990, Société Acodim v Etablissements Rabaud.

<sup>42</sup> Article 19 of the Commercial Agents Directive.

The European Court of Justice has ruled that the guaranteed rights of agents on termination still applied where an agent carried on its activity in a Member State although the principal was established in a non-member country and a clause of the contract stipulated that the contract was to be governed by the law of that country.<sup>43</sup> The choice of law clause remains however valid with regard to other aspects, for example with regard to the establishment of a breach or non-performance.<sup>44</sup> Thus, the principal cannot simply contract out of the Commercial Agents Directive. However, as far as an agent's activity outside of the EU is concerned, the Commercial Agents Directive as well as national implementing legislation can be excluded.

As these rights to indemnity and compensation do in principle not apply to distribution contracts, parties often insert a clause excluding agency.

However, it is not excluded that a "formal" distribution contract is re-qualified into an agency contract. In Germany, agents' rights may even be applied to distributors if their situation is similar (see below point 4.3.2.b).

#### (b) Distributors

EU law provides no particular basis for distributors to claim compensation or indemnity on (rightful) termination (indemnity for loss of clients). Such claims may of course arise out of the contract, grounds for indemnification being for example the failure to terminate according to the terms of the contract, the failure to give notice, the fact that there were no reasonable grounds for termination etc. (damages for wrongful termination), but there is no European legal basis for the payment of compensation or indemnity solely on the grounds of termination of the distribution contract.

The same situation prevails in France, courts refusing to grant distributors the right to an indemnity for loss of clients, in the absence of a contractual provision to that effect.

In some countries, however, a protection of distributors has arisen out of the protection of commercial agents. For instance, under German written law there is no protection for distributors. However, the German courts extended the agency protection to distributors and other independent sales people.<sup>45</sup> The protection will apply if the specific situation of the person/legal entity the contract of which has been terminated resembles the position of an agent. In general, the more a distributor is integrated into the sales organization of the supplier the more likely it will be that the courts will award compensation. Integration is likely to be established where there is control or influence exercised over marketing, pricing, minimum sales requirements, reporting obligations of the distributor and other similar control mechanisms. Furthermore, in order to award indemnity to distributors the courts require that the distributor must be obliged contractually to transfer its client data to the supplier on termination of the contract, which will allow the supplier to profit from the distributor's activity.<sup>46</sup> A prior contractual exclusion of the indemnity due to distributors in this case would not be effective.

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<sup>43</sup> Judgment of the European Court of Justice of 9 November 2000, Case C-381/98, *Ingmar GB Ltd v Eaton Leonard Technologies Inc.*

<sup>44</sup> Michael J. Dean: *International Distribution Overview of Relevant Distribution Laws: Europe*. March 2007. Section 7.7.

<sup>45</sup> Judgment of the *Bundesgerichtshof* of 11 December 1958, BGHZ 29, p. 83.

<sup>46</sup> Judgment of the *Bundesgerichtshof* of 13 June 2007, BB 2007, p. 1586.



The Swiss *Bundesgericht* has recently taken a similar decision, stating that the distributor, in analogous application of the law on agency, is entitled to an indemnity on termination of its contract, if it is integrated into the sales organization of the supplier and disposes of only limited economic autonomy, which makes its situation comparable to that of an agent. Moreover, the distributor must have built up or extended a client basis, which will on termination of the distribution contract be transferred to the supplier. Unlike the German courts, the Swiss court does not seem to require a contractual obligation to transfer the client data, so that a factual transfer would be sufficient.<sup>47</sup>

Thus, there are legal requirements for payment of compensation or indemnity on termination in all EU Member States as far as agents are concerned, and in some Member States as far as (some) distributors are concerned.

## **5. NON-COMPETE / RESTRICTIVE COVENANTS**

### **5.1 Non-compete clauses**

#### **5.1.1 Non-compete clauses and the prohibition of restrictive agreements**

Non-compete clauses are restrictive of (intra-brand) competition and thus contrary to article 81 (1) ECT, but may be exempted under article 81 (3) ECT or the Exemption Regulation. However, article 5 of the Exemption Regulation imposes certain conditions for the exemption.

Under the Exemption Regulation, a non-compete obligation means any direct or indirect obligation causing the buyer not to manufacture, purchase, sell or resell goods or services which compete with the contract goods or services, or any direct or indirect obligation on the buyer to purchase from the supplier or from another undertaking designated by the supplier more than 80% of the buyer's total purchases of the contract goods or services. Quantity forcing is thus also covered to a certain extent.

Non-compete clauses are in principle exempted if the supplier's market share does not exceed 30%. If the supplier's market share exceeds the threshold, an exemption may be granted with reference to article 81 (3) ECT and the Guidelines on Vertical Restraints.

However, article 5 (a) of the Exemption Regulation provides that the exemption under the Exemption Regulation shall not apply to any direct or indirect non-compete obligation, the duration of which is indefinite or exceeds five years. A non-compete obligation which is tacitly renewable beyond a period of five years is deemed to have been concluded for an indefinite duration.

If an obligation on the buyer to purchase more than 80% of its total demands from the same supplier is indefinite, automatically renewable or exceeds five years, it will not be enforceable, but will not, unlike hardcore restrictions, constitute an obstacle to the exemption of the rest of the contract, if it is severable from the other clauses, which has to be determined in each case.

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<sup>47</sup> BGE, 134 III 497.

For instance, a contract between a brewery and a tenant providing that during the duration of the lease (20 years), the tenant had to buy its beer exclusively from the brewery (“beer tie”) has been judged contrary to article 81 ECT.<sup>48</sup>

Furthermore, post-term non-competes are only exempted and enforceable if they are necessary to protect the supplier’s substantial know-how, last for less than one year after the termination of the agreement, and are limited to the market and premises on which the buyer operated during the contract period.<sup>49</sup>

Finally, article 5 (c) of the Exemption Regulation provides that the exemption shall not apply to any direct or indirect obligation causing the members of a selective distribution system not to sell the brands of particular competing suppliers. This prohibition is meant to avoid a situation whereby a number of suppliers using the same selective distribution outlets prevent one specific competitor or certain specific competitors from using these outlets to distribute their products (which would be a form of collective boycott). Thus, in case of selective distribution, the appointed dealers can only be obliged not to resell competing brands in general.

Additionally article L.330-1 of the French commercial code limits the duration of exclusive purchase clauses to ten years. This provision might be applied by French courts if the distributor has its seat in France, regardless of the fact that the law applicable to the distribution contract is not the French law.<sup>50</sup> If the parties have included a clause of a duration longer than ten years, French courts will consider that the clause’s duration is reduced to ten years.

Thus a supplier may restrict a distributor’s ability to distribute competing products during and after the term of the relationship. However, there are legal limitations on such restrictions.

### **5.1.2 Non-compete clauses and the prohibition of the abuse of a dominant market position**

Exclusive purchase obligations may also be contrary to article 82 ECT, if the supplier is in a dominant market position. For example, some suppliers of food and drink products require exclusivity in outlets or in vending machines where they supply such machines. The Commission took into account dominance of the suppliers as well as dependence of retailers in condemning such provisions.

For instance, in the Van den Bergh case<sup>51</sup>, an ice cream manufacturer which occupied a dominant position on the Irish market provided ice cream retailers with freezer cabinets, in which it retained ownership, provided that they were used exclusively for the supplier’s products. The distribution contracts did not contain a clause to the effect that the distributors were not allowed to sell competing ice cream products, but the freezer exclusivity clause had almost the same effect, as it was economically not viable for distributors to install a second freezer.

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<sup>48</sup> Judgment of the European Court of Justice of 20 September 2001, Case C-453/99, *Courage Ltd v Bernard Crehan*.

<sup>49</sup> Article 5 (b) of the Exemption Regulation.

<sup>50</sup> Lamy *Droit Economique* 2009, point 4033.

<sup>51</sup> Judgment of the Court of First Instance of 23 October 2003, Case T-65/98, *Van den Bergh Foods Ltd v Commission of the European Communities*.

The Court of First Instance approved the Commission of having found that the freezer exclusivity clause was an infringement of article 81 (1) ECT and that the inducement of the supplier to distributors to enter into freezer agreements subject to a condition of exclusivity, and to maintain the cabinets, constituted an infringement of article 82 ECT. The Court's main argument was the foreclosure effect of the agreement brought about by the fact that the freezer exclusivity clause in reality created outlet exclusivity. The Court states however that such a clause may have a beneficial effect on competition in a balanced market by leading to an improvement in production or distribution of goods.

In the Coca Cola case, the Commission accepted undertakings from Coca Cola Entreprises that the equipment exclusivity contracts would not amount to outlet exclusivity. The commitments reduced contract duration, gave customers the option of repayment and termination without penalty and freed up a certain share of cool space.<sup>52</sup>

### 5.1.3 Drafting of non-compete clauses

In order to avoid uncertainties over which products must not be sold by the distributor, the agreement might contain a list of products which the distributor is allowed to sell, besides the contractual products.

#### *Clause suggestion*

*The DISTRIBUTOR shall not sell any products which are competitive with any of the Products within the Territory. The products listed in Annex 1 are not deemed to be competitive with Products. The Parties may from time to time agree to extend by mutual agreement the list of products not deemed to be competitive with Products.*

### 5.2 Non-solicitation clauses

Distribution contracts in Europe do not necessarily contain special provisions preventing one party from recruiting the other party's employees. The necessity has to be appreciated by the parties according to the nature of the products, i.e. the importance of the employees' expertise and the relationship of the parties. In fact, in a vertical relationship the parties are usually not competitors, but it is not excluded that they are, as competing undertakings sometimes enter into vertical agreements.

Therefore, the parties have to determine what restrictions are appropriate in order to prevent the supplier and distributor from recruiting the other's employees.

From an antitrust law perspective, non-solicitation clauses are in general not problematic, as they are not included as hardcore restrictions or non-compete obligations in the Exemption Regulation.

In the absence of any non-solicitation clause in the distribution contract, a party might be liable under article 1382 of the French civil code for unfair competition, if it hires employees of the other, provided that it is at fault. The mere fact of hiring employees of the other party would not be considered as fault. Special circumstances have to prove the faulty behaviour of the new employer, e.g. the massive hiring of employees causing a disorganization of the old

<sup>52</sup> Commission decision COMP/A.39.116/B2 – Coca-Cola of 22 June 2005.

employer's company or the knowledge the new employer has of a non-compete clause contained in the employment contract.<sup>53</sup>

## **6. PRODUCT RECALL**

The distributed products may be defective. The defect may concern a single product, but can also be a structural defect which might lead to a large scale product recall.

Directive 2001/95/EC of the European Parliament and of the Council of 3 December 2001 on general product safety provides that product recall is an obligation of producers (product manufacturers). Within the limits of their respective activities, producers shall adopt measures commensurate with the characteristics of the products which they supply, enabling them to (a) be informed of risks which these products might pose and (b) choose to take appropriate action including, if necessary to avoid these risks, withdrawal from the market (i.e. before the products have been sold to consumers), adequately and effectively warning consumers or recall from consumers.

Recall shall take place as a last resort, where other measures would not suffice to prevent the risks involved, where the producers consider it necessary or where they are obliged to do so further to a measure taken by the competent authority.

Distributors shall act with due care to help to ensure compliance with the applicable safety requirements, in particular by not supplying products which they know or should have presumed do not comply with those requirements. Moreover they shall participate in monitoring the safety of products placed on the market, especially by passing on information on product risks, keeping and providing the documentation necessary for tracing the origin of products, and cooperating in the action taken by producers and competent authorities to avoid the risks.

The supplier generally undertakes to indemnify the distributor for the damages suffered due to the fact that the supplier's products are defective, including a product recall.

## **7. INFRINGEMENT OF INTELLECTUAL PROPERTY RIGHTS**

Under EU antitrust law, a distribution contract including accessory clauses on intellectual property will be exempted according to the general rules.

### **7.1 The parties' warranties on intellectual property rights**

The supplier usually warrants that it is the rightful owner of the trademark in the territory granted to the distributor.

The distributor does usually not provide any intellectual property rights, but is in general granted the right to use the supplier's trade mark. However, the distributor may also provide

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<sup>53</sup> Mémento pratique Francis Lefèbvre, Concurrence Consommation, 2013, point 8180.

intellectual property rights, in particular if the parties are competitors and if their distribution agreement is part of a larger cooperation.

The supplier usually grants the distributor the right to use its trade mark, but this is not necessarily the case.<sup>54</sup> A trademark license is used in franchising agreements, but rarely in distribution agreements where the distributor is restricted to selling the finished products.

The supplier has to use all legal possibilities in order to guarantee the distributor the exclusivity of the supplier's trade mark in the distributor's territory.

## **7.2 Infringement of intellectual property rights by the distributor**

### **7.2.1 Infringement of the supplier's intellectual property rights by the distributor**

The parties usually provide explicitly that nothing in the distribution contract can be interpreted as constituting, for the benefit of the distributor, the transfer or the granting of rights on the supplier's intellectual property rights.

Infringement of the suppliers' intellectual property rights by the distributor may be a ground for the supplier to immediately terminate the distribution contract.

### **7.2.2 Infringement of third parties' intellectual property rights by the distributor**

In case the supplier's intellectual property rights are in conflict with third parties' prevailing intellectual property rights, the supplier will usually compensate the distributor for any damages suffered because of third parties' actions brought against the distributor.

## **7.3 Infringement of the supplier's intellectual property rights by third parties**

### **7.3.1 A typical case of infringement: Selling of marked products re-imported from outside of the EEA**

Where due to EU antitrust law, the supplier may not forbid the (passive) resale of the products by the distributor to a buyer situated outside of the distributor's allocated territory, the supplier may find a remedy in EU law on intellectual property, allowing it to prevent parallel importing of its marked products from a third country into the European Economic Area (the "EEA").

Indeed, article 7 (1) of First Council Directive 89/104/EEC of 21 December 1988 to approximate the laws of the Member States relating to trade marks (the "**Trade Mark Directive**") provides that "the trade mark shall not entitle the proprietor to prohibit its use in relation to goods which have been put on the market in the Community under that trade mark by the proprietor or with his consent." The European Court of Justice has interpreted this provision in a case where an Austrian manufacturer of spectacles had sold some out-of-fashion products for a cheap price to a distributor in Bulgaria (at the time not yet member of the EEA) with the instruction of not re-exporting them to the Community. In a way not

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<sup>54</sup> Lamy Droit Economique 2013, point 4445.

clarified, the spectacles reappeared on the Austrian market, and the manufacturer brought an action for interim relief, seeking an injunction restraining the importer from offering the spectacles for sale in Austria under its trade mark.

The European Court of Justice ruled that contrary to the Austrian interpretation, article 7 (1) of the Trade Mark Directive did not allow Member States to adopt rules providing for international exhaustion of trade mark rights, i.e. in respect of products put on the market outside the EEA under the trade mark by the proprietor or with its consent.<sup>55</sup> Therefore, the supplier may rely on its trade mark rights in order to prevent the re-importation of its products from countries outside of the EEA.

This remedy is however not available as far as products are concerned which the supplier has put on the market in a country member of the EEA. However, no exhaustion of intellectual property rights takes place if the distributor is able to prove legitimate grounds for its resistance to the resale of its products by the third party, like for example the modification of the state of the products.<sup>56</sup>

### **7.3.2 Cooperation obligation of the distributor**

It is generally provided that the distributor informs the supplier if it gets knowledge of any infringement of the supplier's intellectual property rights or of any act of unfair competition by third parties.

If the supplier decides to sue a third party for infringement of its intellectual property rights, the distributor is usually supposed to cooperate with the supplier, who will direct the proceedings.

## **8. LIMITATION OF LIABILITY AND INDEMNIFICATION**

### **8.1 Legal scope of liability**

Liability is determined according to the law which is applicable to the distribution contract. If it is the French law, the principles of liability are regulated by the French civil code (articles 1146 to 1155). According to these provisions, a party who does not respect the contract is liable to the other party, i.e. it owes to the other party damages (*dommages et intérêts*), if the damage was predictable.

If the parties do not provide anything to the contrary, a party who does not respect any of the obligations imposed by the contract will be liable to the other. It is not necessary to specifically provide for areas in which the parties will be liable.

### **8.2 Contractual limitation of liability and restrictions to such limitations**

#### **8.2.1 Restrictive approach of French courts**

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<sup>55</sup> Judgment of the European Court of Justice of 16 July 1998, Case C-355/96, Silhouette International Schmied GmbH & Co. KG v Hartlauer Handelsgesellschaft mbH.

<sup>56</sup> Lamy Droit Economique 2013, point 4917.

Clauses limiting liability are interpreted in a restrictive way by French courts, in a manner favorable to the person to whom they are opposed. Thus, a clause precluding damages for lost profits would only be applicable if the distribution contract is terminated according to its terms. If the supplier terminates the contract where he was in reality not entitled to do so, he may not refer to the clause precluding damages for lost profits, and French courts would re-establish the financial position in which the distributor would have been if the distribution contract had been correctly performed.<sup>57</sup>

On this note, a clause whereby a distributor waives its right to damages has been judged non applicable if the supplier infringes its obligation not to directly supply the former clients of the distributor in case of termination of the distribution contract at the supplier's initiative.<sup>58</sup>

French courts have developed several validity conditions for liability limitation clauses.

These liability limitation clauses are ineffective if the defaulter commits an intentional or serious fault (*dol ou faute lourde*).<sup>59</sup>

Liability limitation clauses are also ineffective if the damage results from the non-execution of an "essential obligation", which is the justification / purpose of the contract (*cause*). This principle was established in a case where a French company specialized in fast transporting services limited its liability in its contracts to the amount paid by the client for the transport, whereas the real damage was a lot higher, as the sender had missed the deadline to participate in a tender, due to the failure of the transportation company to deliver the mail in time. The French courts ruled that the limitation of liability was ineffective, as it was the very purpose of the contract that the mail be delivered before the deadline.<sup>60</sup>

Applying this principle for example to an exclusive distribution contract, the supplier whose essential obligation is to grant exclusivity to the distributor in a given territory would not be able to limit its liability in case it does not respect this exclusivity.

Furthermore, a liability limitation clause cannot touch compensation for physical damage to the person of a contractor. Moreover, in contracts between business people and consumers, limitation of liability is not tolerated.<sup>61</sup>

Thus, there are restrictions on the effectiveness of limitations of liability.

### **8.2.2 Possibilities of contractual limitation of liability**

Apart from these restrictions, the parties are free to limit liability in the contract or subject it to certain conditions. For example, the supplier assumes liability for claims by third parties the distributor has to face based on the fact that the distributed products are defective due to their manufacture by the supplier (see below point 8.4). However, this liability may be limited by the determination of conditions, e.g. that the distributor notifies the supplier of the claim within a certain time period after having been informed of the claim.

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<sup>57</sup> Lamy Droit Economique 2013, point 4290.

<sup>58</sup> Lamy Droit Economique 2013, point 4277.

<sup>59</sup> Cour d'appel de Paris, 15 September 1992.

<sup>60</sup> Cour de cassation, chambre commerciale, 22 October 1996, Chronopost.

<sup>61</sup> Article L. 132-1 of the French consumption code.

Moreover, the supplier may undertake to replace defective products at its costs. This obligation may also be subjected to certain conditions, e.g. that the distributor returns the defective products to the supplier within a certain period of time.

It is also possible to directly limit the amount of indemnity to be paid by a party liable to the other.

### **8.3 Contractual determination of indemnities**

As far as contractual indemnities are concerned, the parties may provide that in case of termination of the distribution contract, the distributor will receive an indemnity for loss of clients (*indemnité de clientèle*).

The parties may also fix an amount in the contract which has to be paid if one of the parties does not fulfill its obligations (contractual penalty). French courts control the amount of the penalty and are authorized to modify it if the penalty seems obviously excessive or insignificant.<sup>62</sup>

Thus, there are restrictions on the provision of indemnities by the parties.

For the special type of indemnity paid to commercial agents in case of termination of their contract, please refer to point 4.3.2.a above.

### **8.4 Liability towards third parties**

Due to the French law principle that contracts only oblige the contracting parties, the supplier is in general not liable towards the distributor's clients. The distributor may however turn on the supplier and obtain from him an amount equal to the damages paid to the third party.

However, there are some important exceptions, i.e. that the distributor's clients may bring an action for damages directly against the supplier, if the products have a hidden defect (*vice caché*) or if they are dangerous due to a defect (liability for defective products),<sup>63</sup> in which case the victim may request damages from either the manufacturer, the final seller or any intermediary.<sup>64</sup>

The parties may include a clause to the effect that if a third party brings an action against either the distributor or the supplier in relation to a defect of a product manufactured by the supplier, it is in any case the supplier who will defend or settle, as the supplier will bear the final liability (the distributor being entitled to turn on him) and as it has at its disposal all possible information on the manufacturing of the products in question.

### **8.5 Statute of limitations**

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<sup>62</sup> Article 1152 of the French civil code.

<sup>63</sup> Lamy Droit Economique 2013, point 4465.

<sup>64</sup> Article 1386-7 of the French civil code.



As to the time period during which either party may bring an action against the other, it is limited by French law to five years.<sup>65</sup> According to article 2254 of the French civil code, the parties may shorten (and extend) the duration of the time period during which they may bring actions. However, they may not reduce said duration to less than one year.

## 9. CHOICE OF LAW AND FORUM

As in an international distribution contract, the parties come from two different countries and jurisdictions, the choice of a neutral jurisdiction (law and forum) seems to be an acceptable compromise. However, if the parties choose a neutral jurisdiction, none of them is familiar with the law chosen, maybe not even with the country's language. That's why most of the times, the law chosen is one of the party's, in general the law of the supplier.

Therefore, no recommendation can be given to choose a neutral jurisdiction for the applicable law and the choice of forum.

### 9.1 Choice of law

As far as the framework (distribution) contract is concerned<sup>66</sup>, the choice of law applicable to contracts is regulated by the convention on the law applicable to contractual obligations opened for signature in Rome on 19 June 1980 ("**Rome Convention**"). The Rome Convention will be replaced by Regulation (EC) no 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I<sup>67</sup>) ("**Rome I Regulation**"), with effect as of December 17, 2009. The Rome Convention will continue to apply as far as Denmark and the United Kingdom are concerned, these two countries having decided not to participate in the adoption and application of the Rome I Regulation. In this section, reference will be made to the rules of the Rome I Regulation.

Under article 3 of the Rome I Regulation, the parties are free to determine the law which is to rule their contract. The choice shall be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or to part only of the contract. Thus there are no statutory or other legal restrictions on the choice of law.

However, the Rome I Regulation provides that where all other elements relevant to the situation at the time of the choice are located in a country other than the country whose law has been chosen, the choice of the parties shall not prejudice the application of provisions of the law of that other country which cannot be derogated from by agreement.<sup>68</sup>

Furthermore, the Rome I Regulation recognizes overriding mandatory provisions (*lois de police*) which it defines as provisions the respect for which is regarded as crucial by a country

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<sup>65</sup> Article 2224 of the French civil code.

<sup>66</sup> The application contracts (sale contracts) may fall under the United Nations Convention on contracts for the international sale of goods, Vienna 11 April 1980, which determines substantial rules. If this convention is not applicable, for example if it has been excluded, the applicable law should be determined by the Hague Convention of 15 June 1955 on the law applicable to international sales of goods (if the forum is in France who has signed this treaty).

<sup>67</sup> The name "Rome I" is used in order to distinguish it from Regulation (EC) no 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations (Rome II).

<sup>68</sup> Article 3 paragraph 3 of the Rome I Regulation.

for safeguarding its public interests, such as its political, social or economic organization, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under the Rome I Regulation. The concept of "overriding mandatory provisions" is to be distinguished from the expression "provisions which cannot be derogated from by agreement" and should be construed more restrictively.

According to article 9 paragraphs 2 and 3 of the Rome I Regulation, a judge may apply the overriding mandatory provisions of the forum, notwithstanding the law applicable according to the Rome I Regulation. He may also apply overriding mandatory provisions of the country (other than the forum) where the obligations arising out of the contract have to be or have been performed, in so far as those overriding mandatory provisions render the performance of the contract unlawful. In considering whether to give effect to those provisions, regard shall be had to their nature and purpose and to the consequences of their application or non-application.

Article 3 paragraph 4 of the Rome I Regulation provides that where all other elements relevant to the situation at the time of the choice are located in one or more Member States, the parties' choice of applicable law other than that of a Member State shall not prejudice the application of provisions of Community law, where appropriate as implemented in the Member State of the forum, which cannot be derogated from by agreement. Thus, EU law can also belong to the category of "provisions which cannot be derogated from by agreement". For example, EU antitrust law cannot be excluded by the parties by choosing another applicable law than that of a Member State. The same is true for some aspects of EU law on agency (see above point 4.3.2.a).

Therefore, there are certain provisions of local law that will be applied irrespective of a choice of another law.

## **9.2 Choice of forum**

### **9.2.1 National courts**

Jurisdictional issues in the EU are regulated among others by Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, also called Brussels Regulation, as it is based on the Brussels Convention of 1968<sup>69</sup>, which is an international treaty signed by the EU Member States and that contains basically the same rules as the new Brussels Regulation, with some minor differences. The Brussels Convention is still applicable in relations between Denmark and the other Member States.

According to article 23 of the Brussels Regulation, the parties to a contract can determine which Member State's courts shall have jurisdiction to adjudicate a dispute, with the exception of disputes involving consumers (who can be sued only in their country of domicile, if the other party pursues commercial or professional activities in the Member State of the consumer's domicile or, by any means, directs such activities to that Member State<sup>70</sup>).

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<sup>69</sup> Convention on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, signed on 27 September 1968.

<sup>70</sup> Articles 15 and 16 of the Brussels Regulation.

In order to be effective the forum selection clause must be in writing or evidenced in writing, or in a form which accords with practices which the parties have established between themselves or, in international trade or commerce, in a form which accords with a usage of which the parties are or ought to have been aware and which in such trade or commerce is widely known and regularly used. Communication by electronic means which provides a durable record of the contract shall be equivalent to “writing”.

If the Brussels Regulation is not applicable or if it refers to the national law of the Member States, jurisdiction is determined according to the national rules. In France, article 48 of the civil proceedings code provides conditions of validity for jurisdiction clauses. These are only effective between business people (as opposed to consumers) and must be obviously stated in the contract.

We can therefore say that there are few legal restrictions on choice of forum, which are not relevant as far as distribution contracts are concerned (as they are always concluded between business people).

### 9.2.2 Arbitration

Under article 27 of the Brussels Regulation, where proceedings involving the same course of action and between the same parties are brought in the courts of different Member States, any court other than the court first seized must stay its proceedings until the court first seized determines jurisdiction. This procedural requirement can be an obstacle to an “exclusive jurisdiction” clause in a distribution contract as the European Court of Justice has ruled that there is no exception to article 27 of the Brussels Regulation even if the jurisdiction of the court second seized was claimed under an agreement conferring jurisdiction.<sup>71</sup> Additionally, the European Court of Justice has ruled that anti-suit injunctions, by means of which one court could prevent a foreign court from carrying on with its proceedings to determine jurisdiction, are not compatible with the Brussels Regulation.<sup>72</sup>

In a similar case concerning payment of interest on a loan, the German company commenced proceedings against its lenders in Germany in breach of an exclusive jurisdiction clause in favor of the English courts. Seized by the lenders, the English High Court ruled that the proceedings commenced by the lenders were required to be stayed under article 27 of the Brussels Regulation. The German court finally declined jurisdiction, but only after an 18-month delay.<sup>73</sup> However, article 27 of the Brussels Regulation did not prevent the English court from granting in the meantime an order preventing the German borrower from disposing its most valuable assets without the consent of the lenders, the cause of action being different from the proceedings pending in Germany.

In order to avoid this problem, the parties might include an arbitration clause into the distribution contract, as arbitration is outside of the scope of the Brussels Regulation. Therefore, the arbitration tribunal does not have to stay proceedings in favor of a court first seized in breach of an arbitration agreement. However, in Case C-185/07, Allianz SpA and Generali Assicurazioni Generali SpA v West Tankers Inc., the European Court of Justice

<sup>71</sup> Judgment of the European Court of Justice of 9 December 2003, Case C-116/02, Erich Gasser GmbH v MISAT Srl.

<sup>72</sup> Judgments of the European Court of Justice of 27 April 2004, Case C-159/02, Gregory Paul Turner v Felix Fareed Ismail Grovit e.a. and of 10 February 2009, Case C-185/07, Allianz SpA and Generali Assicurazioni Generali SpA v West Tankers Inc.

<sup>73</sup> Judgment of the *Landgericht Mainz* of 13 September 2005, PrimaCom AG v JP Morgan Europe Limited.

stated that anti-suit injunctions are incompatible with the Brussels Regulation, even if the court of a Member State makes the injunction on the ground that the proceedings commenced before the courts of another Member State would be contrary to an arbitration agreement. Thus, the applicability of an arbitration agreement, including in particular its validity, does fall within the scope of application of the Brussels Regulation.<sup>74</sup>

As far as the place of the arbitration is concerned, there may be an advantage in choosing Switzerland, as the parties might then have a chance to escape to a certain degree from European antitrust rules. Recently, the Swiss *Bundesgericht* has in fact decided that antitrust rules (including European antitrust rules) are not part of the Swiss public policy. A national court would be able to annul an arbitral award only if it were contrary to public policy. Thus, a court would not control the way in which an arbitration tribunal applied antitrust rules. However, if a party asks for its application, a Swiss arbitration tribunal would still be obliged to apply European antitrust law which is considered by the *Bundesgericht* as a foreign overriding mandatory provision (*loi de police étrangère*), even if the parties have chosen Swiss law as the law applicable to their contractual relationship. A court may thus annul an arbitration award if the arbitration tribunal did not apply antitrust law in spite of a party's request, but the court would not be able to examine whether antitrust rules were correctly applied.<sup>75</sup>

Unlike the Swiss *Bundesgericht*, the European Court of Justice does consider article 81 ECT as part of the Member States' public policy, which means that a national court to which an application is made for annulment of an arbitration award must grant that application if it considers that the award in question is in fact contrary to article 81 ECT (if its domestic rules of procedure require it to grant an application for annulment founded on failure to observe national rules of public policy).<sup>76</sup>

Therefore, whereas in the EU Member States the application of antitrust rules by arbitration tribunals is strictly controlled, a Swiss arbitration tribunal would have more latitude in applying these rules.

Thus, there may be advantages in choosing arbitration.

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<sup>74</sup> Judgment of the European Court of Justice of 10 February 2009, Case C-185/07, Allianz SpA and Generali Assicurazioni Generali SpA v West Tankers Inc.

<sup>75</sup> Judgment of the *Bundesgericht* of 8 March 2006, ATF 132III389.

<sup>76</sup> Judgment of the European Court of Justice of 1 June 1999, Case C-126/97, Eco Swiss China Time Ltd v Benetton International NV.

## **Annex**

### **Questions used as a guideline for the present contribution**

#### **1. Grant and reservation of rights, including product definition**

What rights should be granted and what rights reserved to the supplier?

What are the consequences of reserving substantial rights in areas such as pricing and channels of distribution? Are there consequences under antitrust and competition laws? Might such reservations affect whether a relationship is an agency or a distributorship and limit termination rights? What is the difference between an agency and a distributor?

How should new products be treated? Should brand and line extensions be treated differently from entirely new product lines?

#### **2. Termination**

Are there statutory or other legal restrictions on a supplier's right to terminate the relationship? Are there elements of a relationship that can trigger such restrictions?

Are there statutory or other legal requirements for payment of compensation or indemnity on termination?

What grounds for termination are most important for a supplier? What protections against unjust termination does a distributor need? Are there circumstances under which a distributor needs the right to terminate?

#### **3. Non-compete / restrictive covenants**

May a supplier restrict a distributor's ability to distribute competing products during or after the term of the relationship? Are there any legal limitations on such restrictions?

How should such competing products clauses be drafted to avoid disputes on what is prohibited?

What concerns should a multi-line distributor have when faced with a competing products clause?

What restrictions are appropriate to prevent the supplier and distributor from recruiting the other's employees? May such restriction extend beyond the term of the agreement?

#### **4. Product Recall**

Under what circumstances may either party initiate a recall?

How are the costs of recall allocated between supplier and distributor? What costs should be covered?

#### **5. Infringement of intellectual property rights**

What warranties of IP ownership from the supplier should be included?

Will the distributor be providing any IP rights? What warranties of those rights should be provided?

What are the parties' duties with respect to third party infringement of IP rights?

What are the parties' rights with respect to infringement by the other?

## **6. Limitation of liability and indemnification**

What limitations on liability may be included? Are there statutory or other legal restrictions on the effectiveness of such limitations?

Does a limitation precluding damages for lost profits impair a distributor's ability to obtain damages for wrongful termination?

Are there any statutory or other legal restrictions on the provision of indemnities by either party?

In what areas should the supplier and the distributor provide indemnification to the other?

What should the scope of indemnification be? Should all claims alleging an indemnifiable act be indemnified or only claims established to be valid?

Should indemnification include a duty to defend? Who should select counsel? Who should have authority to settle?

Is it possible to limit the time period during which either party may bring an action against the other?

## **7. Choice of law and forum**

Are there statutory or other legal restrictions on choice of law?

Are there certain provisions of local law that will be applied irrespective of a choice of other law?

Are there statutory or other legal restrictions on choice of forum?

Are there particular advantages or disadvantages of arbitration for suppliers and distributors?

Should a neutral jurisdiction be chosen for applicable law and choice of forum?