

TERMINATING COMMERCIAL CONTRACTS IN FRANCE

By Thomas Fleinert-Jensen, Almain A.A.R.P.I.

The end of a commercial contract is often a critical moment. A substantial part of disputes between business partners occur at or around this stage. Disputes might obviously be caused by an alleged breach of contract by one of the parties. But conflicts arise even if the agreement has been performed properly. Termination of commercial contracts should consequently be considered with care already at the negotiation stage.

French law leaves a large margin for the parties to determine when and how their commercial agreement shall terminate. There are however specific provisions of French law, which have to be kept in mind, especially related to the requirement of a proper termination notice period.

EU law also influences French commercial contracts, in particular with respect to applicable competition rules.

This paper will address some basic thoughts on how to best anticipate and manage the end of commercial contracts in France, distinguishing between distribution agreements, including franchise, on the one hand, and commercial agency agreements, which are subject to specific rules, on the other hand.

1. Distribution and Franchising

Distribution agreements allow a supplier to sell products to an independent distributor who in turn sells the products to its own clients.

The parties are basically free to agree upon the term of the distribution agreement, whether defined or undefined, upon specific cases of termination, such as merger, change of control or change of management, and upon the consequences of the termination.

If the agreement has an undefined term, it may be terminated anytime, subject to adequate notice, by either party without such party having to provide any specific ground or explanation.

No compensation is due to the distributor after the end of a distribution agreement, unless otherwise agreed by the parties.

Franchise agreements are not very different from other distribution agreements in this respect. They are subject to specific disclosure requirements before they can be executed, but the rules regarding termination are close to any other agreement.

Despite the freedom granted to the parties, they might want to anticipate the following issues.

➤ **Watch out for the term**

In distribution agreements with a **defined term**, neither party may terminate the agreement before it has reached its term, except in the case of breach of contract. The term should consequently be the best compromise between stability and flexibility. A supplier may want to reorganize the distribution network swiftly, in which case a short term is preferable. Conversely, a distributor may want a longer term in order to protect heavy investments. The adequate term is very much a question of circumstances.

Some limitations exist to the parties' right to freely choose the term. A non-compete clause prohibiting the distributor from purchasing goods or services from third parties which compete with the goods or services of the supplier would not be automatically held valid under EU competition rules if it exceeds five years.¹ This is an incentive for the parties to limit the agreements, or at least the non-compete clause, to five years. Otherwise, the parties would have to evidence that the non-compete clause is acceptable from a competition perspective.

In other instances, a minimum term is required. Motor vehicle distribution agreements are held automatically valid from a EU competition standpoint if their term is at least of five years.²

Distribution agreements with an **undefined term** are valid under French law. In this case, both parties may terminate the agreement anytime, subject to proper termination notice.

➤ **Provide Adequate Termination Notice**

It is a requirement under French law that a party provides adequate notice to the other party before terminating a business relationship. This rule is one of the main restrictions to contractual freedom in business relationships.

The idea behind this rule is to leave enough time to the other party to adapt and find new business partners. This is seen as being of particular importance in business between major retail chains (Carrefour, Auchan, Intermarché...) and smaller suppliers having less market power. The French legislator has intended to rebalance the relations through a variety of mandatory rules, including the prohibition of brutal termination.

The rule is set out under Article L 442-6-I-5° of the French Commercial Code. It is **applicable to all "established business relationships"**, which includes termination of agreements of undefined term, termination of tacitly renewable agreements of defined term and also, depending on circumstances, termination of a series of agreements of defined term entered into one after the other. Article L 442-6-I-5° is not only applicable when a formal agreement exists but in all cases where an established business flow exists between the parties.³

As an exception to the rule, a distribution agreement can be terminated without notice in the case of termination for cause. The breach has to be serious in order to allow immediate termination.⁴ The mere circumstance that the relations between the parties have become conflicting would not allow immediate termination.⁵ Furthermore, the party in breach must be put on notice beforehand.⁶

Immediate termination could also be valid in case of force majeure, but there are few examples in case law.

In a case where a firm performed badly and consequently terminated relationships with some of its business partners, the Court of Appeals of Versailles held that poor performance did not allow immediate termination.⁷ Similarly, the fact that a firm is in jeopardy due to international competition is not a case of force majeure, and does consequently not entitle the firm to terminate a business relationship without notice.⁸

Strike can be a case of force majeure allowing immediate termination.⁹

In all other cases, an established business relationship requires adequate notice before termination. This is the case for total termination: discontinuation of orders¹⁰, products taken out of distributor's catalogue¹¹, non-renewal of a distribution agreement, etc.

This is also the case for partial termination, such as a significant reduction of orders for instance.¹²

The lack of any prior notice makes the termination brutal *per se*.¹³

The risk for the terminating party is to be held liable for the damages suffered because of the brutal interruption of the business relationship.

Compensation is due for the damage suffered due to the brutal breach, *i.e.* the lack of adequate notice. Any other damage would not be compensated under Article L 442-6-1-5°. ¹⁴ Brutal breach is different from wrongful termination, which can be defined as the abuse of the right to terminate.

The damage is basically the gross margin lost during the missing notice period.¹⁵ It is typically assessed as the difference between turnover and variable costs, less fixed costs savings linked to the termination, if any, and increased by any additional costs and inventory which has become unusable.

The actual compensated damage very much depends on each particular circumstance. The compensation might be decreased if the concerned party has taken the risk to have only one main client and not to diversify. This is especially the case if the terminated party was warned several times and did not react by finding other clients. It has consequently become common practice in distribution agreements to include a clause whereby the supplier is required not to limit its business to the sole distributor but to find other clients.

Negative image impact, and more generally moral damage, is rarely considered as a damage for brutal termination.¹⁶ In one instance, the Commercial Court of Paris considered that such damage existed and should be compensated since the brutal termination took place when a fashion collection was under preparation. The victim could consequently not advertise on the new collection.¹⁷

Loss of investments are usually not considered as damages to be compensated. In most cases, the Courts consider that investments were made at the own risks of the terminated party.

Neither are redundancy costs often considered as damages. They are usually more linked to the termination itself rather than the brutal nature of such termination.¹⁸ However, it can be understood from a judgment of the *Cour de cassation* that redundancy costs could be

compensated if the concerned company was unable to find another job to the employees within the firm or the group.¹⁹

How long should the termination notice be?

The distribution agreement should not necessarily be the guide. The termination notice inserted in the agreement can be considered too short, in which case it is set aside and the Court determines what the proper notice period would have been.²⁰

The main criteria to determine the required length of the notice is the duration of the business relationship which is terminated.

The business relationship can be limited to the duration of the agreement, whether of defined or undefined term. Should the parties have begun doing business before the agreement came into force, that period should be added as well.²¹ In the absence of any formal agreement, it is the length of the business relationship which is taken into consideration.

The Court of Appeals of Paris held that several agreements of fixed term, which were systematically renewed, could be considered as an established business relationship.²² This depends however on the specific circumstances. The *Cour de cassation* held that several construction agreements over a six years' period did not generate an established business relationship as they were independent, there was no exclusivity and there could be no expectation that the business level would be maintained over time.²³ The Court of Appeals of Versailles held that there was no established business relationship if the agreements were renewed after an open bidding procedure.²⁴

In case of merger, the agreement is transferred to the new entity pursuant to article L 236-3-I of the Commercial Code. The total duration with the former company and the new one has to be taken into consideration²⁵, except in certain circumstances where the agreement cannot be transferred.

Once the length of the business relationship has been determined, the Courts assess the length of the required notice period. The laws do not give any specific guidance and the required length is assessed on a case-by-case basis.

Here are a couple of examples:

Business Relationship	Area of Business	Required Notice Period
30 years	Champagne bottle decoration	2 years
17 years	Silk product manufacturing	18 months
10 years	Apparel	1 year
5 years	Mass retail	6 months
1 year	Tractor rental	2 months

➤ **Consider Foreign Law and a Foreign Court**

Sometimes the parties consider skipping the French rules on brutal termination by submitting the agreement to the laws of a country where the termination notice agreed between the parties will apply without any other consideration.

Such decision should be taken after carefully outweighing pros and cons. If the required termination notice may be longer under French law than in other countries, no compensation is due to the distributor after termination, unlike in a number of other jurisdictions.

Choice of law clauses are enforceable before French Courts, as they would be in most other jurisdiction.

European rules, which are applicable in France, have confirmed this. According to article 3 of the “Rome I” EU Regulation of 17 June 2008:

“A contract shall be governed by the law chosen by the parties. 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.”²⁶

The enforceability of such clauses can however be limited by mandatory rules of French international public order.

Article 6 of the Civil Code prohibits all clauses which are contrary to public order.

Similarly, according to article 9 of the Rome I regulation, mandatory rules of public order shall prevail:

“Overriding mandatory provisions are provisions the respect of which is regarded as crucial by a country 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 this Regulation.”

There is no definitive list of rules of French rules of international public order. In this respect, the rules prohibiting brutal breach of a business relation are considered as applicable to agreements governed by foreign law.²⁷ If a dispute concerning the brutal termination of an agreement governed by foreign law is submitted to a French Court, such Court shall apply article L 442-6-I-5.

This is the reason why the parties could consider submitting disputes to a foreign Court, in practice a Court of the country which law is applicable to the agreement.

The question was raised whether the rules on brutal breach of established business relationships should necessarily be judged by French Courts. The *Cour de cassation* considers that this is not the case. In a case opposing the US company Monster Cable Products Inc. to its French distributor, the distribution agreement contained a clause under which any dispute should be dealt with by the Courts of San Francisco. The *Cour de cassation* held that this clause was applicable, despite the circumstance that the dispute on the merits involved rules regarding brutal termination of business relationships.²⁸

Should the dispute regarding brutal termination of business relationship arise between a French company and a European company, the outcome would be the same. According to the *Cour de cassation*, the rules of the EU regulation on international jurisdiction should apply.²⁹ These rules allow choice of forum clauses.³⁰

Arbitration clauses are also applicable to disputes regarding brutal termination of business relationships.³¹

The enforceability of a choice of forum clause is however subject to formal requirements. The Courts want to make sure that such clauses have really been agreed by both parties. A clause, which is written in small fonts, at the bottom of invoices sent by one party to the other would not be held binding.³²

The clause should also be written in fairly broad terms, encompassing disputes arising out of the breach of the agreement, but also the termination of the agreement³³ and the consequences of such termination. This would allow disputes regarding brutal termination of business relationships to be included in the clause, thus ensuring that the Court decided by the parties would effectively be considered as having jurisdiction.

➤ **Keep the Agreement *Intuitu Personae***

It might be worth inserting in the distribution agreement a clause stating that it has been entered into on an *intuitu personae* basis towards one party, or both parties.

For instance, an *intuitu personae* clause would allow a supplier to terminate the agreement should the distributor merge with a third party.³⁴ Such a clause may also work for a change of management, the agreement being considered entered into in consideration of the existing management of the distributor.

Conversely, a franchisee may want to terminate the franchise agreement should some key persons quit the franchisor.

An *intuitu personae* clause would be applied strictly by the Courts and should consequently be written with care. A clause allowing a supplier to terminate the agreement should the distributor merge would not be applicable should only some of the assets of the distributor be transferred to a third party.³⁵

A party may also want to terminate the agreement should a change of control of the other party happen. In this case, specific provisions regarding a change of control should be added.

2. Commercial Agency

Commercial agency is an alternative to independent distributors. According to article L 134-1 of the French Commercial Code, the commercial agent negotiates and, potentially, concludes sales, purchase, lease or services contracts in the name and on behalf of the principal.

The agent is an independent person or legal entity, but at the same time has to follow the instructions of the principal, who is ultimately bound by the agreement with the end client.

The principal has consequently full control on the price offered to the end client, to the contrary of what happens for distributors of franchisees.

French legislation has inspired EU rules on commercial agency, which to a certain extent have harmonized national laws in the EU member states³⁶. From a French perspective, agency agreements are specific in the sense that they are the only agreements pertaining to distribution networks where the distributor (*i.e.* the agent) is entitled to a termination payment, except in the case of termination for cause.

➤ ***Provide Adequate Termination Notice***

Adequate termination notice in agency agreements is required by article L 134-11 of the Commercial Code:

- One month if the agreement lasted less than a year
- Two months if the agreement lasted between one and two years
- Three months if the agreement lasted over two years.

If an agency agreement, which initially had a defined term, continued to be applied by the parties after the initial term, it is construed as of undefined term. The period to be considered to determine the adequate notice shall include the initial defined term and the time the agreement has lasted after the initial term.

It is noteworthy that the provisions of article L 442-6-I-5, pursuant to which adequate termination notice has to be provided – which can be longer than the notice set out in the agreement - are not applicable to agency agreements.³⁷

➤ ***Be Prepared for a Termination Payment***

A commercial agent is entitled to a termination payment at the end of the agreement. This rule is set out under article L 134-12 of the Commercial Code.

The indemnity is a compensation for the damage suffered by the agent. The law does not specify any amount or any calculation method and it is up to the Courts to assess the right indemnity.

In theory, the payment shall compensate for the loss of income suffered by the agent³⁸, the loss of the ability to transfer the agency agreement to another agent and the loss of the corresponding price³⁹, or the loss of investments made by the agent⁴⁰.

In practice, the termination payment is often assessed to two years' commissions⁴¹, which might be a substantial amount.

The termination payment is in particular due:

- When the principal terminates an agency agreement of undefined term
- At the term of an agency agreement of defined term⁴²
- When the principal does not renew a tacitly renewable agency agreement
- If the commercial agent dies

- If the commercial agent cannot continue acting for the principal due to age or disease⁴³

There are few cases where the indemnity is not due. No payment is due if the commercial agent transfers the agreement to another agent. But the termination payment is due if the principal does not agree upon the new agent without serious grounds.⁴⁴

The main situation where the termination payment can be avoided is the case of breach of contract by the agent. Only serious breach may avoid payment⁴⁵, such as assault on a client⁴⁶, clear lack of interest in selling the products⁴⁷ or visiting clients⁴⁸, or the refusing the principal's sales methods⁴⁹.

A decrease in sales⁵⁰, occasional errors towards clients⁵¹, or missing sales targets set out in the agreement⁵² have not been considered as serious breach.

The Courts are not bound in their assessment by any clause under which the parties have agreed on a definition of serious breach.⁵³

➤ ***Consider Alternative Applicable Law***

The termination payment may be lower in other countries than France. If this is a central issue, the principal might want to have the agency agreement governed by the laws of a country where the termination indemnity would be lower.

The question is whether a French Court would apply the foreign law chosen by the parties or whether the French law on commercial agency would prevail.

The *Cour de cassation* clearly considers that the French rules on commercial agency are not of international public order and that the law governing an international agreement should consequently be applied.⁵⁴ The limits expressed by the European Court of Justice nevertheless remain applicable: the indemnification rules in favour of commercial agents set out by EU directive 86/653 of 18 December 1986 are applicable when the commercial agent acts on EU territory, even if the law of a non-EU member country is chosen for the agreement.⁵⁵

September 2016

-
- ¹ Commission Regulation (EU) No 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices
- ² Article 3.5.a of 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
- ³ Court of Appeals of Paris, 6 May 2009, Class v. Vitry Motoculture; Court of Appeals of Paris, 14 May 2009, RG 06/21725; Cour de cassation, Commercial Chamber, 16 December 2008, No. 07-15.589
- ⁴ Cour de cassation, Commercial Chamber, 25 September 2007, No 06-15.517
- ⁵ Cour de cassation, Commercial Chamber, 15 May 2007, No 05-19.370
- ⁶ Court of Appeals of Paris, 8 January 2009, RG 06/22199
- ⁷ Court of Appeals of Versailles, 18 May 2006, RG 04/08829
- ⁸ Court of Appeals of Caen, 2 June 2005, RG 03-03155
- ⁹ Cour de cassation, Commercial Chamber, 9 October 2007, No 06-16.744
- ¹⁰ Court of Appeals of Paris, 13 February 2009
- ¹¹ Court of Appeals of Paris, 12 January 2005
- ¹² Cour de cassation, Commercial Chamber, 23 January 2007, No 04-17.951
- ¹³ Court of Appeals of Paris, 17 September 2008
- ¹⁴ Cour de cassation, Commercial Chamber, 23 January 2007, no 04-16.779 ; Cour de cassation, Commercial Chamber, 20 October 2015, No 14-18.753
- ¹⁵ Cour de cassation, Commercial Chamber, 28 April 2009, No 08-12.788
- ¹⁶ Cour de cassation, Commercial Chamber, 20 May 2014, No 13-16.398
- ¹⁷ Commercial Court of Paris, 2 April 1999, Esmar v. Galeries Lafayette
- ¹⁸ Cour de cassation, Commercial Chamber, 28 May 2013, No 12-19.147
- ¹⁹ Cour de cassation, Commercial Chamber, 15 September 2009, No 08-10.020
- ²⁰ Cour de cassation, Commercial Chamber, 6 March 2007, No 05-18.121
- ²¹ Cour de cassation, Commercial Chamber, 29 January 2008, No 07-12.039
- ²² Court of Appeals of Paris, 6 May 2009, Class v. Vitry Motoculture
- ²³ Cour de cassation, Commercial Chamber, 16 December 2008, No 07-15.589
- ²⁴ Court of Appeals of Versailles, 18 September 2008, RG 07/07.891
- ²⁵ Cour de cassation, Commercial Chamber, 22 January 2009, No 07-05.197
- ²⁶ Regulation (EC) No 593/2008 of the European Parliament and the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I)
- ²⁷ Court of Appeals of Lyon, 25 September 2008, CCC 2009, No 8; Cour de cassation, Commercial Chamber, 21 October 2008, No 07-12336
- ²⁸ Cour de cassation, 1st Civil Chamber, 22nd October 2008, No 074-15.823
- ²⁹ Cour de cassation, Commercial Chamber, 24th November 2015, No 14-14.924
- ³⁰ Article 25 of EU Regulation of 12 December 2012
- ³¹ Cour de cassation, 1st Civil Chamber, 21 October 2015, No 14-25.080
- ³² Cf. note 29
- ³³ Cf. note 31
- ³⁴ Cour de cassation, Commercial Chamber, 13 December 2005, No 03-16.878
- ³⁵ Cour de cassation, 1st Civil Chamber, 27 May 1997, No 95-12.386
- ³⁶ Directive 86/653 of 18 December 1986
- ³⁷ Cour de cassation, Commercial Chamber, 3 April 2012, No 11-13.527
- ³⁸ Cour de cassation, Commercial Chamber, 16 October 2001, No 99-10.271
- ³⁹ Court of Appeals of Paris, 25 February 2004
- ⁴⁰ Cour de cassation, Commercial Chamber, 29 May 1984, No 83-10.238
- ⁴¹ For instance, Cour de cassation, Commercial Chamber, 25 January 2005, No 03-16.453
- ⁴² Cour de cassation, Commercial Chamber, 9 October 2007, No 06-10.929
- ⁴³ Article L 134-13 of the Commercial Code
- ⁴⁴ Cour de cassation, Commercial Chamber, 17 February 1987, No 85-11.982
- ⁴⁵ Article 134-13 of the Commercial Code
- ⁴⁶ Cour de cassation, Commercial Chamber, 15 May 2007, No 06-12.282

-
- ⁴⁷ Cour de cassation, Commercial Chamber, 10 July 2007, No 06-13.975
- ⁴⁸ Cour of Appeals of Paris, 17 February 2011, RG 06/07930
- ⁴⁹ Cour de cassation, Commercial Chamber, 20 February 2001, No 98-13.656
- ⁵⁰ Cour of Appeals of Grenoble, 23 June 2011, RG 09/02030,
- ⁵¹ Cour de cassation, 29 October 2002, No 99-12.766
- ⁵² Court of Appeals of Paris, 29 March 2012, RG 10/01060
- ⁵³ Cour de cassation, Commercial Chamber, 28 May 2002, No 00-16.857
- ⁵⁴ Cour de cassation, Commercial Chamber, 5 January 2016, NO 14-10.628
- ⁵⁵ European Court of Justice, 9 November 2000, Ingmar GB Ltd. V. Eaton Leonard Technologies Inc, C-381/98