SQUIRE PATTON BOGGS

A French Revolution?

The Key Changes You Need to Know About From the Most Significant Reform of French Contract Law Since 1804

Introduction

French contract law is on the verge of reforming Title III of Book III of its Civil Code on contracts (*"Des contrats ou des obligations conventionnelles en general"*). These provisions, which are at the very heart of French contract law, have remained nearly untouched since their original enactment in 1804. Over the years, French contract law has mainly relied on judicial creativity to formulate new rules where the code was silent, to modernise existing rules and to give practical application to hitherto academic concepts. This reform is intended to update and consolidate the law of contract and to incorporate certain key case law developments. The reform should also be followed by changes to the rules on contractual and tortious liability.

The reform will become law on 1 October 2016. With minor exceptions, all contracts concluded prior to its entry into force will remain subject to the previous regime.

Practical Effect

The changes introduced by the reform will have a significant effect on the negotiation, formulation, execution and termination of contracts under French law. This effect is exacerbated by the fact that, although the role and the powers of the courts will remain fundamentally unchanged, the reform has conferred upon the courts certain additional powers in specific situations. There are also a great number of new principles and standards, which will require judicial interpretation.

Parties contracting under the new revised provisions should be aware of the situations in which a contract may be deemed unenforceable, be aware of when they are able to take advantage of, or are subject to, the opportunity to renegotiate that contract and be alert to any relevant judicial interpretations. More importantly, parties should understand which reform provisions they may contract out of and tailor these according to their needs and priorities.

Parties will need to carefully draft hardship and adverse change clauses and should reduce the risk of their terms being deemed unreasonable by ensuring that the rights and obligations comply with the new standards of fairness and good faith.

Key Changes

- **Freedom of contract** – This principle, which has recently been elevated to constitutional status by a decision of the French Constitutional Council, is expressly included in the reform as "underpinning French contract law". It is stated as follows: "Everyone is free to contract or not to contract, to choose the person with whom to contract, and to determine the content and form of the contract, within the limits imposed by legislation." (Article 1102 as amended).
- **Nevertheless, this contractual freedom is subject to a public policy limitation** – Statutes considered to reflect French public policy may not be derogated from by private agreement. Unfortunately, the code does not specify in each case which rules reflect public policy.
- **Good faith** – The principle of good faith is included in the existing Civil Code and covers the performance of a contract. Good faith will be expressly extended, in line with existing case law, to cover pre-contractual negotiations and their termination. Damages in this regard are limited to those incurred during negotiations, excluding loss of opportunity and loss of profit, for example.
- **Duty to inform during negotiations** – This was developed in French case law and is expanded upon in the reform. As part of the changes, if a party knows of information and knows that the information is of decisive importance to the willingness of the other party to contract, the first party must provide the other with the information. This only applies to information that the other party legitimately does not know or where one party is in a relationship of confidence with the other. This duty cannot be restricted or excluded. Failure to satisfy this requirement may allow the court to set aside the contract on the basis of no consent.
- **Significant imbalance** – In standard-form contracts, (defined as contracts whose general terms and conditions are not subject to negotiation and are determined by one of the parties in advance), any term, other than the contract's main subject matter and the adequacy of the price, that creates a significant imbalance in the rights and obligations of the parties, may be considered void by the courts. Although there is no express list of clauses presumed to create a "significant imbalance", this provision and the practices it targets may possibly mirror those which apply to B2C and B2B practices in Article L.132-1 of the French Consumer Code and Article L.442-6,I, 2 of the French Commercial Code respectively.
- **State of dependency** – Where an abuse of a party in a state of "dependence" (*"état de dépendance"*) leads that party to agree to a commitment where it would not otherwise have done so, and the other party obtains a manifestly excessive advantage, the contract may be declared void by the courts.
- **Determination of price** – Based on previous case law, the reform recognises that a framework contract may provide for the price to be unilaterally set by one of the parties and authorises the provider in service contracts to set the price where no price has been agreed at the outset. If this is done abusively, the court may award damages and, in the case of framework contracts, terminate the contract. As with the significant imbalance provisions, there is no express list of what constitutes abuse, or an indication of how highly subjective matters like level of profit will be treated and this will be for the court to determine.

- **Assignment of contracts and of debt or receivables** – Based on commercial practice and existing case law, the reform has introduced the concept of assignment of contracts and of debt and has simplified the process for assigning receivables. A party will be entitled to assign its rights and obligations under a contract with the prior written consent of the other party. Unless provided otherwise, the assignor will remain jointly and severally liable with the assignee for the performance of the contract, and collateral provided by the assignor will remain enforceable.
- **Limitation of liability** – The reform has introduced the principle that any clause that strips a contract of its substance (i.e. where a party is released from performing its essential obligations) is void. This principle has been used in case law and will be extended under the reform to assess the enforceability of clauses excluding or limiting liability.
- **The reduction of price as a remedy** – Where a contracting party is not satisfied with goods or services or where these do not comply with contractual specifications, it may, after a formal demand and notice without delay, unilaterally accept imperfect contractual performance and reduce the price proportionally. This confers a wide power on the non-defaulting party to decide whether the performance and subsequent payment is correct, without any judicial supervision or any specification as to how such an assessment should be carried out.
- **Hardship** – One of the most striking and commented on changes is the introduction of the concept of hardship, a concept that French law has always refused to recognise, other than in public law agreements. This provides that either party may request the renegotiation of a contract, rather than being compelled to continue performance, when an unforeseeable change in circumstances renders contractual performance excessively onerous, provided that the risk of such change has not been expressly accepted in the contract. Failing successful renegotiation, the parties may terminate the contract at such date and time as they determine. In the absence of an agreement to terminate, the contracting parties – first jointly and then after a reasonable period, unilaterally – may apply to the Court to revise or terminate the contract. Contractual obligations must be complied with during any renegotiation or challenge.
- **Specific performance and termination** – The reform has clarified the remedies available in respect of breach of contract. Remedies will now include (i) compelling a defaulting party to perform the contract, as long as this is not impossible (legally, morally or practically) and that the difference in the cost of performance and the benefit for the non-defaulting party is not manifestly disproportionate, or (ii) elect to perform the contract itself or have it performed by a third party. The defaulting party will bear the costs in any case. The reform also provides for the right to unilaterally terminate a contract by notice after substantial non-performance.
- **Termination of groups of contracts** – The reform recognises the concept of connecting an interdependent group of contracts to achieve a single transaction. Where one contract within this group becomes unenforceable or invalid, its performance being a determining factor for the agreement of a party to the other contracts in the same group or renders their performance impossible, each contract within the group is deemed terminated. This termination only occurs if the contracting parties for each contract knew about the interdependent group of contracts at the time of agreement.

If you would like further information on the new French contractual law provisions, please contact one of our lawyers listed below.

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