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Historic Reforms to the French Civil Code: Ordinance No. 2016-131 and Forthcoming Changes to French Contract Law

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Much discussed and anticipated reforms to the French Civil Code aim to modernize French contract law making it more coherent, predictable and attractive, including to foreign investors. It remains to be seen, however, whether reforms of Ordinance No. 2016-131, published on 10 February 2016 (the "2016 Ordinance") will achieve these goals—or will instead inject additional uncertainty and inefficiencies into the law, dissuading would-be investors wary of how French courts may interpret and apply the reforms to the four corners of agreements.

The reforms of the 2016 Ordinance cover numerous aspects of contract law and can be categorized into three groups: "confirmatory" changes that codify certain aspects of French contract law that had long been applied by French courts, but formally existed only in the realm of case law; "simplifying" changes that eliminate archaic wording and clarify the intended meaning and application of certain Code provisions; and "innovative" changes that introduce new legal concepts and tools to French contract law. Subject to their ratification by the French Parliament, the new rules will take effect on 1 October 2016 and will apply to contracts concluded thereafter. Contracts concluded before 1 October will continue to be governed by the old rules, with the exception of new "interrogatory" tools (described below), which will apply to all contracts, regardless of their effective date.

This article summarizes the key modifications introduced by these reforms and provides practice tips to consider in adapting to the changes.

"Simplifying" Changes

Elements of a Valid Contract. The 2016 Ordinance modifies in certain respects the requisite elements of a valid contract. Unchanged is the requirement that each party must have the capacity to enter into a contract. The requirement of mutual consent of the parties has been updated by Article 1143 of the Civil Code, which codifies the concept that mutual consent will be absent (and a contract thus void) if one party, abusing the state of duress or dependence of its counterparty, obtains the other party's consent (which consent would not have been given in the absence of such duress or dependence) and derives a manifestly excessive advantage from the contract. Additionally, the 2016 Ordinance eliminates the concept of "cause" that was traditionally a principle of French contract law, replacing it at Article 1128 et seq. with a requirement of lawful, certain content ("*un contenu licite et certain*"). Further, according to new Article 1163, each party's obligations must relate to present or future possible and determinate (or determinable) action(s).

"Confirmatory" Changes

Preference Agreements. Consistent with the existing case law on the subject, Article 1123 *et seq.* codifies the concept that where a party breaches a preference obligation to another party (e.g., an obligation with respect to preemptive rights, rights of first offer or refusal, etc.), the defaulting party will be held liable, as will any third party who enters into an agreement with the defaulting party knowingly in violation of the other party's preference rights. The beneficiary may also seek to have a court cancel any such agreement or substitute such party for the third party (in the latter case, thus specifically enforcing its preference rights).

Prohibition on Perpetual Commitments. New Article 1210 *et seq.* introduces to the Civil Code a general prohibition on perpetual contracts (***"engagements perpétuels"***). Rather than rendering contracts with perpetual terms automatically void (which was the approach taken under the most recent French case law on the subject), under the reformed Civil Code, such agreements will remain in effect with "permanent terms" but either party will have a right to terminate after "reasonable" notice unless the contract provides for a specific notice period, in which case the contractually agreed notice period would apply.

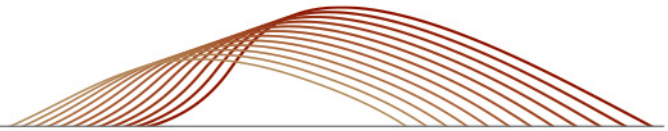
Assignment of Contract ("Cession de Contrat"). Article 1216 provides a party the right to assign its capacity as a party to a contract with the other party's prior written consent, which consent may be provided for in advance as a term of the contract itself. Any such assignment must be evidenced in writing or is void. Unless the parties otherwise agree or provide in the contract, the assigning party will remain jointly and severally liable for the performance of the contract and any securities provided by the assignor will continue to be enforceable by the other party.

Innovative Provisions

Duty to Inform. Article 1112-1 of the 2016 Ordinance also incorporates into the Civil Code the "*devoir d'information*" or duty to inform which hitherto formally existed only in French jurisprudence. The codified version of this duty, however, will impose a broader duty than that previously existing in case law and applies to all types of contracts. Henceforth, a party will be required to share with the other party during negotiations any information that the first party knows concerning the subject matter of the contract to the extent such information would be determinative or critical ("*déterminante*") to obtaining the other party's consent to enter into the agreement, if the counterparty "trusts" the counterparty or is ignorant of the relevant information. This duty does not extend to the estimation of the value of the subject matter of the contract. The party claiming that the other should have provided information will have the burden of proof that such information was owed to him by the other party.

Particularly given the broad and undefined scope of this duty, it is noteworthy that the new Article 1112 provisions regarding the duty to inform specifically provide that parties can neither limit nor contract away this duty. Additionally, pursuant to Article 1130 *et seq.*, a breach of this duty to inform (whether or not intentional) may lead to the cancellation of the contract on a theory of lack of consent. While the 2016 Ordinance confirms that parties have a duty to inform, it introduces new uncertainty about the lengths that the parties will be required to go to satisfy their information obligations to one another under the Civil Code. Contract parties and practitioners will be watching closely to see how courts apply this duty as codified, and whether they will impose any limits on its scope that are not expressly stated in the Civil Code provisions. In the meantime, due diligence processes and the negotiations of representations and warranties will surely be affected.

New Rights in the Context of Unforeseeable Changes. Under new Article 1195, a party for whom performance of a contract becomes "excessively onerous" due to an unforeseeable change in circumstances (which change was a risk that the party did not agree to bear), will have a right



to seek to renegotiate the contract with the counterparty. During any renegotiation, the parties are required to continue to perform their contractual obligations. In the absence of a successful renegotiation, either party may seek judicial interference to rebalance the contract or order it terminated. The 2016 Ordinance leaves to the courts the delineation of the parameters of "unforeseeable changes" that render contract performance "excessively onerous." The new provision is a default rule, the applicability of which parties are free to waive or restrict in the contract (thereby limiting judicial interference with the parties' contractual relationship). Accordingly, desired waivers or limitations should be considered in advance and explicitly stated in the contract, such as in material adverse change or hardship clauses.

Unfair Terms in Contracts of Adhesion. A number of the provisions of the 2016 Ordinance reflect the reformers' intent to codify various protections of the "weaker" party to a contractual relationship. One example is Article 1171 of the new Civil Code, which will provide that courts have the power to nullify "abusive" terms which create "a significant imbalance in the parties' rights and obligations" in contracts of adhesion (i.e., those whose general terms and conditions or terms of use were not negotiated, such as standard form agreements). The terms that can be nullified are those unrelated to the subject matter of the contract or its pricing. Previously under codified French law, this principle was applicable only in the case of consumer contracts or contracts between traders.

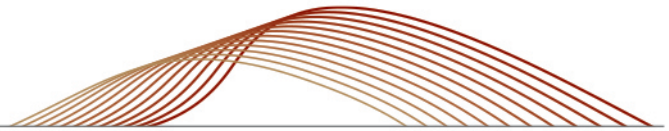
Unilateral Promises. In a departure from the approach taken by the courts, the 2016 Ordinance (Article 1124) provides that a promisee that has received a unilateral promise, such as an option, can specifically enforce performance of the promise by the promisor if the promisor withdraws its promise prior to the expiration of the option period. The French *Cour de Cassation* had held in 1993 that only money damages were available under the same circumstances.

"Interrogatory Tools". The 2016 Ordinance also introduces three new "interrogatory tools" ("*actions interrogatoires*") that are intended to enable a party to put an end to an ambiguous situation by forcing the other party to take a position or action. As noted above, these provisions, once ratified, will be applicable to all contracts subject to the Civil Code, regardless of whether concluded prior to or following the ratification of the 2016 Ordinance.

- New Article 1158 provides that a third party contracting via an agent can formally request the principal to confirm, within a reasonable, specified period of time, whether the agent has the power to bind the principal. Failure to respond to such a request within the specified period of time will make the agent's decisions automatically binding on the principal (an example of a circumstance in which "silence is deemed acquiescence" by law).

- New Article 1123 allows a third party to make a written request to the beneficiary of a preference agreement that the beneficiary confirm within a reasonable and specific period of time whether a preference agreement in fact exists and/or whether the beneficiary intends to exercise its preferential right. The request must state explicitly that in the event that the beneficiary fails to timely reply, the beneficiary will forfeit its right to seek to be substituted for the third party if the third party concludes an agreement with respect to the preference.

- New Article 1183 allows a party that becomes aware of a possible risk of cancellation of the contract (such as a default), to request that the other party either confirm the continuation of the agreement or bring an action for annulment within six months from the first party's request. The default must not be continuing at the time of the request. A counterparty who fails to respond risks being time barred from pursuing future actions for termination for the same reason.



The changes provided for in the 2016 Ordinance are the most significant alterations to French contract law since 1804, when the French Civil Code was established under Napoleon. They apply broadly to contracts governed by French law, and accordingly can be expected to affect nearly all entities doing business in France. Careful consideration should be given to the new and/or modified rights and obligations codified by the 2016 Ordinance—and the extent to which parties may desire to waive or limit them contractually, where permitted under applicable law. Best practices will continue to evolve as these rights and duties are construed by French courts in the disputes that may arise post-ratification of the reforms in October.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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