

# French Regulation of Exclusive Distribution Agreements and Refusal to Sell\*

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## SUMMARY

French regulations on exclusive distribution agreements and on refusal to sell do not constitute a separate body of law, but are included in the general body of price regulation. A small number of articles of law have laid down the principles of regulation, and the Ministry of Finance and Economic Affairs has interpreted the meaning of the articles for a broad range of situations. Enforcement procedures and legal proceedings are generally the same as those applicable to price questions. Offences connected with price are regarded as criminal offences, punishable by fines up to 6 million new francs (about \$1.4 million) and/or imprisonment. The possibility of criminal proceedings has led to most disputes being settled through conciliation, with an implicit assumption that the regulations are being respected, and that violations are accidental. Legal proceedings are taken only in cases of refusal to discontinue the prohibited practices. A party injured under one or more prohibited practices retains the right of redress through normal legal processes.

A number of practices are almost, but not quite, *per se* prohibited. These may be summarized as :

1. a refusal to sell or to deal when the buyer's request is "normal";
2. a discrimination in price or in terms of sale which is not justifiable in terms of differences in cost;
3. a restriction on the pricing freedom of the reseller, particularly on minimum resale price (except under a Ministerial exemption, which is rarely given);

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4. a sale conditional on the purchase of other goods (a tying agreement), or on the purchase of minimum quantities (a requirements contract).

Thus a vendor, unless he can invoke one of the exceptions discussed in the paper, cannot refuse to sell or to deal:

(1) If he is a manufacturer who normally sells through wholesalers, he cannot refuse to sell at wholesale price to *any* purchaser who buys in normal wholesale quantities;

(2) If he is a manufacturer who normally sells through retailers, he cannot refuse to sell at existing retail trade discounts to *any* purchaser who buys in normal retail quantities;

(3) If he is a wholesaler who sells to retailers, he cannot refuse to sell at existing retail trade discounts to *any* purchaser who buys in normal retail quantities;

(4) If he is a retailer, he cannot refuse to sell to *any* purchaser at normal terms of sale.

The obligation to allow all buyers and sellers an equal access to trade relationships casts doubt on the acceptability of some franchise systems or exclusive dealerships as we know them in North America. To be legally acceptable in France, an exclusive contract must, *as a minimum*:

(1) have, as a demonstrable goal, the improvement of service rendered to consumers; and

(2) leave the licensee totally free to set his own resale prices; and

(3) give to the licensee an exclusive territory, the boundaries of which are strictly defined; and

(4) be bilaterally exclusive in that the licensee agrees not to deal in competing products of third parties.

This French regulation arises from, and is based on, a long-standing political-economic philosophy that destabilizing movements in the general price level are to be avoided at all costs. No such dominant philosophy, except, perhaps, a qualified acceptance of what Galbraith calls the "rule of competition", has underlain North American anti-trust philosophy, which may account for the latter's uncertain direction and interpretation.

It is clear that the French regulations represent a much stricter enforcement of anti-trust law than exists in either Canada or the United States. In fact, French interpretation is at least as strict again, compared to U.S. law, as the latter is compared to Canadian enforcement. Few of the exclusive distribution agreements now in

force in North America would satisfy all the conditions mentioned, and thus be acceptable under French law.

## INTRODUCTION — THE CANADIAN AND U.S. POSITIONS

These notes on French regulation concerning exclusive distribution agreements and refusal to sell arose from a continuing study of franchise systems being carried out by the writer under the sponsorship of the Marketing Science Institute. Franchising may be described as an arrangement whereby a firm (the franchisor) which has developed a pattern or formula for the conduct of a business, extends to other firms (the franchisees) the right to engage in the business *subject* to a number of restrictions and controls. Two of these restrictions, exclusive franchising and exclusive dealing, and a related practice, refusal to sell, are discussed in this paper.

A franchisee often obtains the use of the franchisor's name and "formula" for doing business, along with the product or service involved, on an exclusive franchising basis. That is, the franchisee has the sole right to handle the product or service in a given geographical area. In return, the franchisee may agree (expressly or by implication) to deal exclusively in the products of the franchisor — that is, not to handle the products of third parties. The result is a bilaterally exclusive agreement.

In Canada, these restrictions are covered by sections 33A, 33B, 33C, and 34 of the *Combines Investigation Act*.<sup>1</sup> In the United States, they are subject to possible constraint under the *Sherman*,<sup>2</sup> *Clayton*,<sup>3</sup> and *Federal Trade Commission Acts*.<sup>4</sup> It is useful to consider the scope of Canadian and United States legislation and judicial or administrative agency interpretation pertaining to these distribution restrictions before looking at the French situation.

*Exclusive Franchising.* It is necessary to define the term "exclusive franchising" with some care, because there are few concepts in anti-trust law which have been so widely misunderstood. Exclusive franchising is an agreement, made by a market supplier with a dealer, that he will not sell his product to any other dealer within the

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<sup>1</sup> R.S.C. 1952, c. 314.

<sup>2</sup> July 2, 1890, c. 647, 26 Stat. 209 and July 7, 1955, c. 281, 69 Stat. 282, 15 U.S.C. §§ 1-7.

<sup>3</sup> Oct. 15, 1914, c. 323, 38 Stat. 730, 15 U.S.C. §§ 12-27, 44.

<sup>4</sup> Sept. 26, 1914, c. 311, 38 Stat. 717, 15 U.S.C. §§ 41-51.

latter's territory, and will not sell there directly himself.<sup>5</sup> Exclusive franchising implies *only* a system of highly selective distribution. It does not *require the* existence of a reciprocal exclusive dealing arrangement (although this is often found), nor does it require the granting of exclusive territorial rights to the dealer. While exclusive franchising is normally thought of as being applied at the retail level, it also exists at the wholesale level, even with products where it is *not* used at retail e.g., with national manufacturers of beverage syrups such as Coca-Cola, Pepsi-Cola, and Seven Up.

Most exclusive franchises are limited in duration, the time span depending on the reason for adopting this method of distribution. Most commonly, exclusiveness is "introductory", that is, limited to a period of one or two years to give the dealer an opportunity to recoup his heavy initial investment in advertising and sales promotion. At the other extreme, exclusive franchises may run as long as ten years, or may be issued for an indefinite term, in which case they are normally cancellable on notice.<sup>6</sup>

There is no question that exclusivity has *some* anti-competitive effects on competition. If other outlets are unable to sell the product economically in the territory under exclusive franchise, then intra-brand competition is effectively foreclosed. Nevertheless, courts in Canada and the United States have held in general that exclusive franchises are not *per se* illegal and that a supplier may grant rights to use his trade name to whom he wishes. The U.S. position is more carefully spelled out. In the absence of unfair, unreasonable, or monopolistic conduct, a supplier is permitted to sell to some dealers and to refuse to sell to other potential dealers in the same area to assure those dealers of their exclusive status; and, subject to requirements of good faith in dealing, to drop those dealers whose performance is not satisfactory.<sup>7</sup>

The Canadian position is much less well defined, although it is certainly more permissive than the American. In a recent case invol-

<sup>5</sup> Less extreme forms are also found. Thus, the supplier may reserve the right to sell directly (but not exclusively) to national or governmental accounts within the territory. Or, the supplier may grant exclusivity only to the dealer's particular type of outlet, reserving the right to sell to other types of wholesalers or retailers within the territory.

<sup>6</sup> A. H. Travers, Jr., and Thomas D. Wright, *Restricted Channels of Distribution Under the Sherman Act*, (1962), 75 Harv. L. Rev. 803.

<sup>7</sup> *United States v. Parke, Davis & Co.*, (1960), 362 U.S. 29, 4 L.Ed. 2d 505, 80 S.Ct. 503; *Lawlor v. National Screen Serv. Corp.*, (1957), 352 U.S. 992, 1 L.Ed. 2d 540, 77 S.Ct. 526; and *Schwing Motor Co. v. Hudson Sales Corp.*, (1956), 239 F. 2d 176 (4th Cir.), cert. denied, (1957), 355 U.S. 823, 2 L.Ed. 2d 38, 78 S.Ct. 30.

ing collective exclusive franchising and collective exclusive dealing agreements,<sup>8</sup> the issue concerned arrangements among seven paper manufacturers and a number of wholesale paper merchants whereby only the merchants would act as distributors of fine papers, and the merchants would handle only papers made by the mills. The parties were convicted under the Criminal Code for preventing or unduly lessening competition. Mr. Justice Cartwright, as he then was, stated:

[T]he decisions... appear... to hold that an agreement to prevent or lessen competition in commercial activities of the sort described in the section becomes criminal when the prevention or lessening agreed upon reaches the point at which the participants in the agreement become free to carry on those activities virtually unaffected by the influence of competition... that it is the arrogation to the members of the combination of the power to carry on their activities without competition which is rendered unlawful; that the question whether the power so obtained is in fact misused is treated as irrelevant; and that the Court... is neither required nor permitted to inquire whether in the particular case the intended and actual results of the agreement have in fact benefited or harmed the public... The relevant question thus becomes the extent to which the prevention and limitation of competition are agreed to be carried and not the economic effect of carrying out the agreement...<sup>9</sup>

In both Canada and the United States, a supplier cannot deliberately choose, as sources of supply or channels of distribution, the suppliers or the customers of competing firms with the intention of driving those firms out of business.<sup>10</sup> Nor can he make his selection of dealers as part of an unlawful boycott or conspiracy.<sup>11</sup>

*Refusal to Sell.* One significant question which has not yet been answered relates to the supplier's right to refuse to sell to dealers as a method of controlling their purchases, customers, or resale prices.

In Canada, it was noted as early as 1907 that the existence of a price restriction would invalidate a refusal to sell that might otherwise be legal.<sup>12</sup> Section 34 of the *Combines Investigation Act*,<sup>13</sup> which prohibits the practice of resale price maintenance, makes it an offence to refuse to deal with any other person who will not follow established resale prices. The 1960 amendment to the Act<sup>14</sup>

<sup>8</sup> *Howard Smith Paper Mills Ltd. v. R.*, [1957] S.C.R. 403, 26 C.R. 1, 118 C.C.C. 321, 8 D.L.R. (2d) 449.

<sup>9</sup> *Ibid.*, at pp. 426-7 (S.C.R.), p. 473 (D.L.R.).

<sup>10</sup> *Maryland Baking Co., v. F.T.C.*, (1957), 243 F. 2d 716 (4th Cir.).

<sup>11</sup> *Eastern States Retail Lumber Dealers' Ass'n v. United States*, (1914), 234 U.S. 600, 58 L.Ed. 1490, 34 S.Ct. 951.

<sup>12</sup> *R. v. Master Plumbers and Steam Fitters' Cooperative Ass'n*, (1907) 14 O.L.R. 295; 12 C.C.C. 371.

<sup>13</sup> R.S.C. 1952, c. 314.

<sup>14</sup> 8-9 Eliz. II, S.C. 1960, c. 45, s. 14.

made some defences available to a person charged under this section where the person supplied used the articles as loss leaders, or for other unfair purposes.<sup>15</sup>

Prior to 1945, virtually all U.S. cases acknowledged the supplier's right to refuse to sell to anyone in the absence of monopolization.<sup>16</sup> Cases since then have differing interpretations. The present U.S. position seems to be that a supplier may advise his dealers with respect to any competitive activity, and may suggest appropriate actions. But, he may not automatically terminate his relationship with them for failure to conform to his advice. In the United States (although not in Canada), a large supplier is probably forbidden *per se* from using a refusal to sell to control the purchases or competitive decisions of his dealers. In the U.S., termination of a dealership in order to implement resale price maintenance is forbidden not only as an unfair act, but also as activity pursuant to implied contracts in restraint of trade.<sup>17</sup> The issue is thus not whether the supplier has the right to unilaterally refuse to sell to dealers, but whether he and his dealers may combine to restrain competition through resale price maintenance.

*Exclusive dealing.* Exclusive dealing is an agreement by a dealer to purchase, sell, or otherwise deal only in products produced by, or approved by, the supplier. The agreement may be express or implied.<sup>18</sup> There are two distinct types of exclusive dealing arrangements. The first is the situation where a supplier requires his dealers not to sell products which are substitutes for those which he supplies. Essentially all of the case law involving exclusive dealing has been concerned with this type. The second type involves a supplier prohibiting his dealers from selling products which, although not competitive with those trademarked products he supplies, involve the same issues of quality maintenance and dilution of dealer sales efforts as do substitute products.<sup>19</sup>

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<sup>15</sup> *Howard Smith Paper Mills Ltd. v. R.*, [1957] S.C.R. 403, 26 C.R. 1, 118 C.C.C. 321, 8 D.L.R. (2d) 449; and *R. v. Master Plumbers*, (1907), 14 D.L.R. 295; 12 C.C.C. 371.

<sup>16</sup> *F.T.C. v. Raymond Brothers-Clark Co.*, (1924), 263 U.S. 565, 68 L.Ed. 448, 44 S.Ct. 162.

<sup>17</sup> *George W. Warner & Co. v. Black & Decker Manufacturing Co.*, (1960), 277 F. 2d 787 (2d Cir.).

<sup>18</sup> Implied agreements are achieved through the granting of special prices, discounts, or other benefits to those dealers who do not purchase competitor's products or services.

<sup>19</sup> The best United States example is *Susser v. Carvel Corp.*, (1962), 206 F. Supp. 636 (S.D.N.Y.), *aff'd* (1964), 332 F. 2d 505 (2d Cir.).

Regardless of the validity of the business purpose underlying exclusive dealing, such arrangements may still cause anti-competitive effects. Whenever a large or dominant market supplier obtains for his exclusive use outlets on a lower level of distribution, there is a serious risk that lesser suppliers will find themselves either weakened or completely excluded from participation in the market. Once a dominant supplier in a market appropriates for his exclusive use a correspondingly large share of available outlets, he has likely succeeded in imposing prohibitive cost disadvantages on existing or potential rivals, since they may have to create new outlets for their goods. The same is true where a group of suppliers collectively (if not collusively) obtain exclusive obligations from dealers, thus producing an aggregate foreclosure.

Nevertheless, exclusive dealing requirements have traditionally not been *per se* illegal in either Canada or the United States, except when accompanied by an attempt to monopolize or to fix prices.<sup>20</sup> In general, a United States court will inquire into the business conditions surrounding the imposition of exclusive dealing requirements and their economic effects on competitors. If there is a valid business reason for the requirement, and if competitors are not foreclosed from a source of supply, then the restrictions are probably legal.<sup>21</sup>

These U.S. criteria probably also hold in Canada, although the situation is less clearly defined. The best statement of the Canadian position on exclusive dealing arrangements is probably that of Justice Cartwright in the *Howard Smith* case.<sup>22</sup>

A recent research inquiry, under Section 42 of the *Combines Investigation Act*,<sup>23</sup> concerned the distribution and sale of TBA (tires, batteries, accessory) items by oil companies through service stations.<sup>24</sup> Based on the *Report*, it was recommended by the Commission that:

agreements or arrangements which give one or more suppliers exclusive or preferred access to a group of outlets in return for a commission on sales to such outlets be prohibited where such agreements or arrangements

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<sup>20</sup> *Howard Smith Paper Mills Ltd. v. R.*, [1957] S.C.R. 403, 26 C.R. 1, 118 C.C.C. 321, 8 D.L.R. (2d) 449; *R. v. Master Plumbers*, (1907), 14 O.L.R. 295, 12 C.C.C. 371; *Susser v. Carvel*, (1962), 206 F. Supp. 636 (S.D.N.Y.), *aff'd.* (1964), 332 F. 2d 505 (2d Cir.).

<sup>21</sup> *Tampa Electric Co. v. Nashville Coal Co.*, (1960), 365 U.S. 320, at p. 335, 5 L.Ed. 2d 580, 81 S.Ct. 623.

<sup>22</sup> [1957] S.C.R. 403, at pp. 426-7, 8 D.L.R. (2d), at p. 473, cited *supra* at p. 602.

<sup>23</sup> R.S.C. 1952, c. 314.

<sup>24</sup> Director of Investigation and Research, *Combines Investigation Act*, Department of Justice, *Report*, (Ottawa, 1962).

are likely to lessen competition substantially, tend to create a monopoly, or exclude competitors from a market to a significant degree...

the incentive for market access agreements would be removed by prohibition of exclusive dealing and tying arrangements...<sup>25</sup>

The Commission recommended that exclusive dealing and tying arrangements be defined and included in the *Combines Investigation Act*,<sup>26</sup> and that they be forbidden. The recommendations are at present under consideration as part of a revision of the Act as a whole.

*French Regulation.* French regulation of exclusive distribution agreements, whether carried out under franchising, licensing, or other contractual relationships, normally comes under the aegis of economic legislation relating to "refusal to sell", and accompanying legislation relating to the practice of discriminatory conditions of sale. The regulations discussed below were studied for their applicability to franchise systems. It should be emphasized, however, that the decrees, laws and circulars involved do not mention franchising or any other specific arrangements as such, and are equally applicable to all types of exclusive distribution arrangements.

#### FRENCH POLITICAL-ECONOMIC PHILOSOPHY

A discussion of regulation of competition in France is best begun with a mention of the strong link between regulation and national economic policy, and in particular with French thinking on matters of price. Historically, it is the extreme French sensitivity to movements in the general price level<sup>27</sup> which underlies most French economic legislation, including that on price.

The sensitivity to price level movement arises from a long-standing political-economic philosophy that the standard of living should be improved by reducing costs and prices rather than by increasing wage levels. It is argued that increased wages and prices produce a fear of continued inflation as well as harming the competitive position of French exports and increasing the attractiveness of foreign imports. Thus the French prohibit, *a priori*, any agreement that tends to destabilize price and prohibit, *a posteriori*, any cartel which abuses its position by actions liable to destabilize price.<sup>28</sup>

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<sup>25</sup> *Ibid.*, at pp. 133-135.

<sup>26</sup> R.S.C. 1952, c. 314.

<sup>27</sup> Not only upward price movements, although these are of greatest concern, but any movements which might have a destabilizing effect on the economy. Where the dividing line between stable (small) and unstable (large) price movement occurs is not clear. Apparently price reductions are more acceptable than price increases of the same size.

<sup>28</sup> The actual fixing of a price or markup is an offence *per se* only if it is a minimum price or markup. Thus resale price maintenance is prohibited. Vendors



One ordinance prohibits outright: "every concerted action, agreement, combine, (express or implied), or trade coalition in any form upon any grounds whatsoever, which has the object or may have the effect of interfering with full competition by hindering the reduction of production costs or selling prices or by encouraging the artificial increase of prices...", and, "any engagement or agreement relating to such prohibited practice shall be absolutely void."<sup>29</sup>

All refusals to sell or to deal, with some exceptions mentioned below, would thus seem to be prohibited. It must be emphasized that, where exclusive agreements are forbidden, it is the implicit refusal to sell or to deal, with its implied effect on price levels, which in most cases constitutes the violation.

The Technical Commission, the agency charged with investigating restrictive trade practices, has gone so far as to state that French law is not adverse to either a cartel or a government controlled limitation on competition, so long as the net effect on the price level is to produce greater stability than would exist if competition were allowed to function unhindered.<sup>30</sup> Thus even a restriction on normal competition may be permissible if it does not destabilize price, and is otherwise in the public interest.

#### PRICE ORDINANCE 45-1483

Under French economic regulation, both the refusal to sell and the continual or habitual practice of discriminatory conditions of sale are prohibited under Price Ordinance No. 45-1483 of June 30, 1945, of which article 37 is of relevance to this paper.<sup>31</sup>

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are free to set maximum prices which they regard as the highest figure at which the product should be resold if stating such a maximum price does not destabilize the existing price and if the maximum price is not intended to and does not, in fact, become a "recommended" price.

<sup>29</sup> Article 59 bis of Section IV, Part III of Price Ordinance No. 45-1483 of June 30, 1945, as amended by decree 53-704 of August 9, 1953.

<sup>30</sup> *Commission Technique Des Ententes, Rapports Au Ministre Chargé Des Affaires Economiques Pour Les Années 1954 à 1959*, (1961), p. 45.

<sup>31</sup> Technically, these are prohibited under Decree No. 58-545 of June 24, 1958. The legislation includes Decree No. 45-1483 of June 30, 1945, as supplemented and amended by Decrees No. 53-704 of August 9, 1953, No. 58-545 of June 24, 1958, and No. 59-1004 of August 17, 1959, and by Act No. 63-628 of July 2, 1963. These are officially incorporated as Price Ordinance No. 45-1483 of June 30, 1945.

The major portion of Decree 53-704 was annulled by the *Conseil d'Etat*, which rules on the correctness or *ultra vires* content of a law or decree. The substance

Article 37-1(a) reads :

Est assimilé à la pratique des prix illicites le fait:

1. Par tout producteur, commerçant, industriel ou artisan:

a) De refuser de satisfaire, dans la mesure de ses disponibilités et dans les conditions conformes aux usages commerciaux, aux demandes des acheteurs de produits ou aux demandes de prestation de services, lorsque ces demandes ne présentent aucun caractère anormal, qu'elles émanent de demandeurs de bonne foi et que la vente de produits ou la prestation de services n'est pas interdite par la loi ou par un règlement de l'autorité publique, ainsi que de pratiquer habituellement des conditions discriminatoires de vente ou des majorations discriminatoires de prix qui ne sont pas justifiées par des augmentations correspondantes du prix de revient de la fourniture ou du service.

The legal obligation to allow all buyers and sellers equal access to trade relationships casts doubt on the licensing of franchisees or other exclusive dealerships. The question is whether manufacturers or wholesalers are to be allowed to choose their resellers and to reserve exclusively for these resellers the distribution of the product or service.

It was assumed, immediately after the appearance of article 37, that exclusive agreements and the whole area of selective distribution were exempt from legal challenge because of the lack of any specific legislation or decree on the subject. Instead, jurisprudence has considered exclusive agreements from the standpoint of their implicit refusal to sell or to deal and has allowed such agreements only where very strict conditions are met.<sup>32</sup>

The remainder of this paper discusses the conditions in Article 37-1(a), the legislative interpretation of French law, and the effect

of this decree was re-enacted by Decree No. 58-545 of June 24, 1958, made under powers vested in the government under the law of December 13, 1957.

Decree No. 58-545 was originally aimed solely at the prohibition of enforced or maintained pricing, but its interpretation has been extended to include the areas of refusal to sell and conditions of sale even in those cases where price maintenance is not an issue.

The difference between a decree and an act, in French jurisprudence, is one of origin. A decree originates with the head of state, an act with a legislative process. Both have equal force of law.

<sup>32</sup> There are few cases available for analysis because most complaints are resolved at the Ministry level by injunction or agreement rather than through the courts. Since offences connected with price are regarded as criminal offences and since the Criminal Court may impose fines up to 6 million new francs (about \$1.4 million) and even imprisonment, the mere possibility of criminal proceedings means that an out-of-court settlement is usually reached. From 1958 to 1964, the Ministries of Economic Affairs and Trade received 648 complaints on refusal to sell or to deal, of which 484 were settled informally and only 7 became the basis for judicial action. The remainder appear to have been dismissed for lack of evidence.

of those regulations of the European Economic Community which exist parallel to French legislation, and which modify its application in significant ways.

#### INTERPRETATION AND RULINGS ON REFUSAL TO SELL

From the original wording of article 37-1(a) through one supplemental act and three decrees, refusal to sell was not *per se* illegal. Rather, its illegality depended on the existence of the conditions mentioned above, which may be summarized as: (1) the existence of the ability or capacity to sell; (2) conditions of sale corresponding to normal commercial usage; (3) demand of a normal character; (4) a buyer acting in good faith; and, (5) products whose sale is not forbidden by law, or by public authority.

A full discussion of the conditions under which refusal to sell (and hence exclusive dealing) could be justified occurred in the "Fontanet" Circular of March 31, 1960.<sup>33</sup> The circular has an unusual status. Although it is related to "legislation" by its content and official source, it is only a commentary and is not binding on either the courts or on private parties.<sup>34</sup> It is, however, morally binding on the Administration in terms of what will and will not be enforced. Frequently, a new court decision results in a revised circular re-interpreting the law.

The purpose of the measures discussed in the Fontanet Circular was to prohibit the imposition of minimum or other destabilizing prices, and to encourage price competition. Price competition is felt to be effective only where all purchasers have equal access to goods and services. Thus, the Circular sets out two prohibitions made to ensure such equality of access. The first prohibition is that of refusal to sell or to deal; the second, of discriminatory prices or conditions of sale. A breach of either involves liability both for those committing the breach and for those inducing it.

The Circular interprets, and the courts have expanded upon, the conditions in article 37-1(a). The offence of refusal to sell is possible

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<sup>33</sup> A circular is a detailed interpretation of the Administration, in this case the Ministry of Finance and Economic Affairs, on what a law or decree actually says. The Fontanet Circular followed and interpreted the Decrees of 1953 and 1958 (see *supra* footnote 31). The circular frequently takes the name of its author, in this case, Joseph Fontanet, Secretary of State for Internal Commerce.

<sup>34</sup> The *Conseil d'Etat* in judgments of May 5, 1961, and June 14, 1961, ruled that the Fontanet Circular merely had the force of a commentary and not the force of regulation, and therefore could not be challenged as *ultra vires*. See *Gaz. Pal.* 1961. 411.

only if six of these are fulfilled *simultaneously*. The six conditions arise where:

1. There is a refusal to initiate or to continue business dealings, or an attempt to meet an order only under conditions different from those requested by the purchaser and therefore unacceptable to him. A vendor's refusal to supply a branded or trademarked product, even when he is willing to supply an unbranded (or differently branded) product of identical specifications renders him guilty of refusal to sell.<sup>35</sup>
2. There is a refusal to meet an order in accordance with customary business practice. The term "customary practice" refers to the terms of the order, for example of credit and delivery, and not the situation where it is customary to refuse to sell to certain classes of dealers such as price cutters.
3. The sale of the product itself is not prohibited by law or regulation.
4. The person refusing to sell was able to meet the request — either he was in possession of the product requested, or he was able to obtain or manufacture it. Under an interpretation of the *Cour de Cassation*, a vendor may not refuse to sell from inventory on the grounds of holding supplies for regular customers. He cannot legally choose among customers, but must fill orders in the sequence in which they are received. There can be "no distinction between a trader's occasional customers and his regular customers . . . every purchaser has the right to obtain the goods he needs from any supplier he chooses;" and, it is a violation "to reserve merchandise or goods for specially selected clients."

The final two conditions, relating to the bad faith of a prospective purchaser and the abnormal nature of his request, are also defences to a charge of refusing to sell or to deal. The plaintiff carries the burden of proving the existence of the first four conditions, while the burden of proof is on a defendant who would invoke the "bad faith" or "abnormal request" defences. The defendant must, if the first four conditions exist, be willing to specify and defend his reason for refusing to sell or to deal on the basis of one of these two defences.

5. The request is not made "in bad faith". The most important case is that a reseller at any level is regarded as acting in bad faith if he systematically and regularly sells a product at a price below his invoice price plus transportation and taxes. To claim this

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<sup>35</sup> *Proc. gén. C. de cass. v. Barjolle et Soc. Biscuits Olibet*, Cass., ch. crim., 13 juillet 1961, D. 1961.2.525, Gaz. Pal. 1961.2.84, S. 1961.2.289, J.C.P. 1961.2.12241.

defense, however, the plaintiff must have applied the criteria equally to all his customers, otherwise he is guilty of practicing discriminatory conditions of sale.

A potential purchaser also acts in bad faith if he obtains goods purportedly for processing or resale, where in fact he intends to use the goods in a manner harmful to the vendor — for example, to promote the sale of a competing product. Such a purpose is, as might be expected, difficult to establish before the fact.

6. The request is not of a normal nature. Refusal to sell or to deal is justified and defensible:
  - a) if the quantity of products requested is not proportionate to the needs of the purchaser, or is outside the quantity normally delivered by the vendor.<sup>36</sup> This defence does *not* include refusal to deliver small quantities.<sup>37</sup> Under article 37-1(c) of Price Ordinance 45-1483, it is an offence to make the sale of a product conditional upon the purchase of any minimum quantity. It is possible for the vendor to charge higher unit prices for smaller quantities if he can show that his per-unit expenses for such a transaction justify a higher price;
  - b) if the purchaser lacks the necessary professional qualifications or physical installations. The kind of business or the business methods used, for example, in discount selling, are not sufficient to justify a refusal to sell. However, the refusal may be acceptable when the sale of the product is outside the purchaser's normal business activity as registered in the Commercial Register.

One significant case is that of the prospective purchaser who, because of the special nature of the product or service, does not have the professional qualifications to process or distribute it satisfactorily. Where certain personal qualifications are required, they must be demanded of all purchasers without exception, and the vendor bears the burden of proving that the product or its use demand such qualifications.

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<sup>36</sup> See *Barjolle* case, *ibid.*, and submissions of M. le conseiller Costa.

<sup>37</sup> See the decision of the Court of Appeal of Amiens of June 17, 1965 (unreported) as discussed in *aff. Brunet*, Cass., ch. crim., 22 déc. 1965, D. 1966.2.144. See also *Proc. gén. C. de Douai v. Brunel*, Cass., ch. crim., 9 janv. 1963, D. 1963.2.206, Gaz. Pal. 1963.1.277, J.C.P. 1963.2.13063 and *aff. Nicolas et Soc. Brandt*, *aff. Colin et Soc. Radio-Matériel*, and *Proc. gén. C. de Dijon v. Brunel*, all decided and reported together at Cass., ch. crim., 22 oct. 1964, D. 1964.2.753. *Aff. Nicolas* is also reported at Gaz. Pal. 1964.2.386.

In a similar case, refusal to sell may be justified if a prospective purchaser lacks the necessary physical facilities or equipment — for example, for processing or installation. Again, requirements must be the same for all customers and the burden of proof is on the vendor.<sup>38</sup>

Finally, refusal to sell may be justified in the case of luxury goods which are prestige items, fashion goods, or original models which must be offered for sale in establishments with an appropriate sales staff and facilities.

The concepts of professional qualification, sufficient technical facilities, and luxury goods, while appearing vague, have in fact reached a high degree of refinement under French jurisprudence.<sup>39</sup>

It is not possible to state absolutely how these conditions compare to Canadian and U.S. regulations. Certainly, a defence to refusal to sell might be offered in either country under condition (5), perhaps under (6), and certainly under (3). Conditions (1) and (4) would constitute offences of themselves only where a subsidiary condition (such as an attempt to monopolize) existed, or where there was an enforcement of resale price maintenance. Condition (2) might be *per se* illegal under Sections 33A and 33B of the *Combines Investigation Act*<sup>40</sup> in Canada, and under the *Robinson-Patman Act*<sup>41</sup> in the United States. The essential difference is that, in the absence of unfair, unreasonable, or monopolistic conduct, a supplier in North America is permitted in the first instance to sell, or to refuse to sell, to whom he chooses; a supplier in France is not.

#### INTERPRETATION AND RULINGS ON EXCLUSIVE AGREEMENTS

The Supreme Court of Appeal, in citing the distinction between “good contracts”, which improve the service given to consumers, and “bad contracts” (which, presumably, do not), has demanded of French jurists a detailed analysis of the economic and commercial effects of each exclusive agreement before determining whether it

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<sup>38</sup> See the statement of the *Cour de cassation* in *Proc. gén. Lyon v. Colin et Soc. Radio-Matériel*, Cass., ch. crim., 13 juillet 1961, D. 1961.2.530, Gaz. Pal. 1961.2.85, on the conditions determining the absence of technical competence or facilities.

<sup>39</sup> See the *Radio-Matériel* case, *ibid.*; *Nicolas et Soc. Brandt v. Soc. Photo Radio Club*, Cass., ch. crim., 11 juillet 1962, D. 1962.2.497, Gaz. Pal. 1962.2.132, J.C.P. 1962.2.12799, S. 1962.2.219; *aff. Nicolas et Soc. Brandt*, Cass., ch. crim., 22 oct. 1964, D. 1964.2.753, Gaz. Pal. 1964.2.386; and *Soc. Guerlain v. Ministère public*, Paris, 26 mai 1965, Gaz. Pal. 1965.2.76.

<sup>40</sup> R.S.C. 1952, c. 314.

should be forbidden under "refusal to sell" legislation. It is necessary, then, to define the conditions under which the implied refusal to sell in an exclusive contract becomes acceptable. The conditions are four in number and all *must* be satisfied by an exclusive contract for it to be acceptable. In summary:

1. the exclusive contract must be bilateral in nature;
2. the area assigned the licensee must be strictly defined;
3. the object of the agreement must be the improvement of service to consumers; and,
4. the agreement must not have the effect, directly or indirectly, of restricting the freedom of the licensee in pricing.

The first and most important condition is that the exclusive contract *must* be bilateral, in that each contracting party must accept restrictions on his own commercial freedom. The licensor becomes the sole supplier of the licensee, and the licensee the sole client of the licensor, for competing products in a given area.<sup>42</sup> The existence of a bilateral agreement may be invoked as a defence against refusing to sell to a third party *if* the other three conditions are also met.

A recent decision of the Court of Appeal of Paris has, however, weakened the possibility of successful use of this defence.<sup>43</sup> Under the ruling, a supplier retains the right, *whether he has contractually relinquished it or not*, of adding to the number of franchised dealers in an area in order to meet changing economic or market conditions. New dealers must agree to the conditions imposed on existing members of the system by the supplier to assure the best promotion of his products and/or to maintain the value of a trademark.<sup>44</sup>

Also, the licensee is *not* obligated, whether he has so agreed contractually or not, to sell only the products of one supplier if it would improve consumer welfare for him to do otherwise. He must, however, reserve for his principal supplier the best conditions of display, promotion, and pricing.

Finally, the Supreme Court of Appeal has clarified that the reciprocally exclusive contract must be concluded directly between

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<sup>41</sup> June 19, 1936, c. 592, 49 Stat. 1526, 15 U.S.C. §§ 13, 13a, 13b and 21a.

<sup>42</sup> "Competing products" are defined as those which, however made or used, are intended for the same purposes and may be considered, by reason of price, as appealing to the same group of consumers.

<sup>43</sup> *Soc. Guerlain v. Ministère public*, Paris, 26 mai 1965, Gaz. Pal. 1965.2.76.

<sup>44</sup> *Kusel et Soc. Hédiard-Distribution v. Ministère public*, Paris, 18 nov. 1964, D. 1965.2.792, Gaz. Pal. 1965.2.78.

supplier and distributor.<sup>45</sup> An exclusive agreement resulting from an agreement made with a union or trade association on one or both sides is *per se* inadequate to justify a refusal to sell.

The second condition for an exclusive contract to be acceptable is that the area given to the licensee must be strictly defined. A licensor who has assigned overlapping "exclusive" areas cannot lawfully refuse to sell to a third party in the overlapped area. The requirement of a strict definition of boundaries does not, however, mean that they must be observed. The Court of Appeal of Paris has ruled that, while a zone or area of exclusive agreement must be carefully defined, the boundary lines may *not* be considered to constitute an absolute right.<sup>46</sup>

The third condition is that a main object of the exclusive agreement must be the improvement of service rendered consumers, and the improvement must have some economic or technical basis.<sup>47</sup> Such a basis exists primarily for those products of high technical content, or requiring special professional competence.<sup>48</sup> For example, the exclusive agreement may lead to improvement in the technical knowledge of sales personnel because of special training provided by the licensor and not available elsewhere at reasonable cost. If this enables the licensee to provide improved after-sales service in accordance with supplier requirements, an exclusive agreement could meet the condition of improving the service rendered consumers.

The fourth condition is that, even where the first three requirements are met, the exclusive contract is still illegal if it has the effect of restricting the dealer's freedom to set price or profit margins, or of leading to the imposition of a minimum price. This condition is strictly applied to exclusive contracts because distribution through exclusive dealers is felt to increase the possibility of the licensor coercing the licensee with the threat of contract cancellation.

It is immaterial whether the restriction on pricing freedom is explicit, or implicit in contract terms having a different object — for example the requirement to use co-operative promotional material which contains recommended prices, or the contractual obligation to take no action which might reduce the intrinsic value of the articles offered for sale.

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<sup>45</sup> *Proc. gén. C. de Dijon v. Brunel*, Cass., ch. crim., 22 oct. 1964, D. 1964.2.753.

<sup>46</sup> *Soc. Guerlain v. Ministère public*, Paris, 26 mai 1965, Gaz. Pal. 1965.2.76.

<sup>47</sup> *Proc. gén. C. de Dijon v. Brunel*, Cass., ch. crim., 22 oct. 1964, D. 1964.2.753.

<sup>48</sup> See especially *Nicolas et Soc. Brandt v. Soc. Radio Photo Club*, Cass., ch. crim., 11 juillet 1962, D. 1962.2.497, Gaz. Pal. 1962.2.132, J.C.P. 1962.2.12799, S. 1962.2.219.



Where exclusive distribution is used by a vendor *only* in those areas where distributors have practiced price cutting, it is presumed that the object of the exclusive arrangements is to withhold supplies from price cutters. The only exception is where the licensor can show that he is building up a chain of exclusive dealerships.

The exclusive agreement may not be used as a defence against refusal to sell if it is shown that either of the contracting parties is not respecting the clauses of the contract.<sup>49</sup> The obligations are then assumed to have been waived, *a fortiori*, by mutual consent, and the contract is considered a spurious agreement whose object is to justify refusing to sell to certain distributors.

Finally, if the existence of an exclusive agreement is to be used as a justification for a refusal to sell, the burden is on the contracting parties to establish the existence of the agreement — most commonly, by producing a dated instrument in writing.

Again, it is not possible to state absolutely how these conditions compare to Canadian and U.S. regulations. It is clear that the first condition, the bilateral nature of the contract, and the second condition, the requirement for a strictly defined geographic territory, have no parallel in Canadian or U.S. anti-trust law or practice. The third condition, an agreement the object of which is to improve service to consumers, might be offered as a defence for a restrictive agreement in either country. Existence of the fourth condition, a restriction of the licensee's freedom in pricing, would certainly render the agreement *per se* illegal in either country.

#### ARTICLE 85 OF THE TREATY OF ROME

Although thus far the paper has considered only French law, a summary of French practice concerning exclusive agreements and refusal to sell must also consider the legislation of the European Economic Community (EEC) as contained in the *Treaty of Rome*. While the treaty does not negate French legislation, it does exist parallel to it, and modifies its application in significant ways. For example, in several cases of exclusive agreements involving two or more countries of the EEC, courts in France have refused to consider cases while awaiting a decision from the European Commission on the status of the contracts in question.<sup>50</sup>

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<sup>49</sup> Whether the decisions enabling a licensor or licensee to ignore certain contract clauses under given conditions are relevant here is not clear. To the best of the writer's knowledge, this has not been tested in a French court.

<sup>50</sup> *Sté U.N.E.F. v. Etablissements Costen*, Trib. comm. Seine, 21 mai 1962, [1962] Rev. int. comm., no. 73, p. 29; rev'd, Paris, 26 janv. 1963, D. 1963.2.189, Gaz. Pal. 1963.1.157, J.C.P. 1963.2.13103.

The Treaty of Rome, from the original draft through article 85 of the present text, has prohibited agreements which had, as an object or as a result, any restriction of the "game of competition" between member states.<sup>51</sup> According to the Commission of the European Economic Community, exclusive contracts between parties in two or more member countries have always been considered agreements subject to the restrictions of part I of article 85, and to the various rulings on its application. A summary of the content of exclusive contracts, and of all inter-member commercial agreements, is required in a "notification" addressed to the Commission of the EEC.<sup>52</sup>

Article 85-3 of the treaty exempts the restrictions of 85-1 from being applied to an exclusive agreement, resolution by a trade association, or common practice within an industry which contributes to an improvement of the production or distribution of products, or to the promotion of technical progress in one or more countries, so long as there is no elimination of competition. In two separate decisions of the Court of European Justice,<sup>53</sup> section 85-1 has been declared not applicable to specific agreements because of the application of 85-3.

The Commission of the European Economic Community has condemned, both in the only relevant case<sup>54</sup> and in principle, clauses in an exclusive agreement which result in a partitioning of markets along national boundaries. The condemnation was upheld by the Court of European Justice in a decision of July 13, 1966,<sup>55</sup> and may be considered binding in every case where there is a partitioning of markets for trademarked items.

A study of the treaty indicates that important differences exist between French and EEC regulations on the subject of procedure

<sup>51</sup> The idea of competition as a game exists in the German and Italian as well as the French texts of the treaty.

<sup>52</sup> EEC rule 153 permits certain exclusive contracts to be reported in a special, simplified notification. See *Journal officiel com. eur.* 1962.2921.

<sup>53</sup> *Soc. L.T.M. v. Soc. M.B.U.*, C. just. Commun. europ., 30 juin 1966, *Gaz. Pal.* 1966.2.155, D. 1966.2.669; *Etabl. Consten-Grundig v. Commission de la Communauté*, C. just. Commun. europ., 13 juillet 1966, *Gaz. Pal.* 1966.2.119.

<sup>54</sup> *Etabl. Consten-Grundig. v. Commission de la Communauté*, 20 oct. 1964, *Journal officiel com. eur.* 1964.2545.

<sup>55</sup> A discussion of the key *Consten-Grundig* case may be found at D. 1963.2.189; L. Spier, *Restrictive Business Practices and Competition in the European Community*, (1965), 53 *Cal. L. Rev.* 1337, at pp. 1364-66; K. Newes, *The European Commission's First Major Antitrust Decision*, (1964-65), 20 *The Business Lawyer* 431, at pp. 431-435.

and of violations. Coordination and reconciliation of such differences is provided for under EEC rule 17-9-3 and under article 177 of the treaty relating to the competence of the Court of European Justice for interpretation.

Rule 17-9-3 states that, so long as the Commission of the European Economic Community is not engaged in proceedings, the relevant authorities of each member state have competence to apply article 85-1, and to evaluate whether an exclusive agreement will hinder competition within the EEC. From the point where proceedings are undertaken by the Commission, national authorities must relinquish competence and postpone any pending legislation.

A judge in a French court, confronted with the possible application of the treaty to an exclusive agreement which is before his court, must rule in one of three ways.

1. He may rule that the treaty does not apply because the exclusive agreement has neither the object nor effect of altering trade between EEC members;
2. He may rule that the exclusive agreement does come under article 85-1 of the treaty, but that the condition involved has not yet been the object of a procedure before the Commission. He must then apply the text of the treaty as he interprets it. In cases requiring interpretation he may, under article 177, submit his problem by way of interlocutory question to the European Court of Justice. If his interpretation is not subject to procedures of appeal through national courts, he *must* submit it to the Court of Justice. The latter cannot rule on the exclusive agreement itself, but only on the interpretation of the treaty which is submitted to it.<sup>56</sup>
3. He may rule that the exclusive contract is the subject of a procedure before the Commission. In this case, he must relinquish competence and postpone proceedings until the decision of the Commission is handed down.<sup>57</sup>

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<sup>56</sup> *Soc. Robert Bosch et Soc. Van Rijn v. Soc. de Geus*, C. just. Commun. europ., 6 avril 1962, D. 1962.2.357, J.C.P. 1962.2.12726.

<sup>57</sup> *Soc. nat. des économies familiales v. Soc. Innovation*, Trib. comm. Seine, 5 mars 1963, D. 1963.2.367 and *Soc. Pierre Rivière et Cie. v. Soc. nouvelle des produits alimentaires*, Cass., ch. civ., 12 mars 1963, D. 1963.2.367.