

Early termination clauses in commercial agreements

Imagine two parties signing an agreement for the best... until the worst happens: whether it be supply delays, failures to pay, insolvency or simple economic difficulties, at some point, terminating such agreement may become an absolute necessity. Unless the party mutually agree to terminate such agreement, according to article 1184 of the French Civil Code, in such cases, termination of the agreement must be claimed before the competent French jurisdictions.

However, wouldn't it be easier and faster to allow a party to terminate the agreement prematurely? Early termination clauses offer the possibility to escape lengthy and costly procedures, provided that they are particularly clearly and precisely drafted.

Drafting an early termination clause applicable in case of breach of an agreement (*Clause résolutoire*)

A *clause résolutoire* is considered as a contractual penalty which may be implemented in case of breach of an agreement by a party. In order for it to be effective, such clause must be made in writing and be unambiguous and very precise:

- It must be specifically provided that (i) such clause constitutes an exception to the judicial termination of contract as provided for by article 1184 of the French Civil Code and that (ii) the termination will be *ipso jure*. Indeed, merely stating that in case of failure to pay, the contracting party may, if he wishes so, have the agreement terminated is not sufficient according to French case law.
- The reasons for such termination must be precisely described. Those reasons will very often be non-performance or breach of the agreement and are very strictly interpreted by French jurisdictions. Therefore the agreement must describe precisely under which circumstances such clause may be carried into effect. It has for instance been considered that a *clause résolutoire* provided for in case of non-payment of a rent cannot be

applied to a case of non-payment of occupation charges.

- The terms of the termination must be clearly specified. Unless otherwise provided in the agreement, the termination must be subject to prior notice. In such a case, the way the notice must be carried out must be accurately described (by mail, by registered letter with acknowledgment of receipt or any other means deemed sufficient) as well as the notice period.
- The parties may judge that, in case of material breach, a prior notice would be ill-adapted. If so, the parties must specifically provide in an unambiguous manner (i) that a prior notice is not mandatory and (ii) what is considered as a material breach by the parties.

Considering the above, it may prove useful to provide for gradual penalties depending on the significance of the default. For instance, in case of material breach, a prior notice may be inappropriate. However, in cases considered as minor by the parties, a prior notice may prove useful in order to give a chance to the other contracting party to perform its obligation(s). If such graduation is decided, the clause must be very carefully drafted and describe all events conducting to termination without notice on the one hand, and termination with prior notice on the other hand, as well as the length of the notice period.

Drafting an early termination clause in case there is no breach of an agreement (*Clause de résiliation unilatérale*)

An agreement may be terminated by one party or the other prematurely for purely objective reasons such as change of control, new commercial strategy or financial difficulties of one of the parties. Such clauses are more important in a fixed-term agreement than in an open-ended agreement since, in the latter situation, termination is always permitted subject to a reasonable prior notice. However, it can eventually fix a shorter notice in specific

cases deemed particularly important by the parties.

The efficiency of the *clause de résiliation unilatérale* is subject to particularly careful drafting, in particular with regard to the prior notice:

- The beneficiary of the clause must be identified. It may be only one of the parties.
- The reasons for such termination must be specified. As for the *clause résolutoire*, such reasons may include breach of the agreement. When drafting the clause, the parties may also decide that no reason is necessary in order to terminate the agreement.
- The prior notice and the terms of such notice must be specified. In particular, when drafting the terms of the notice and specifically of the notice period, article L.442-6 I 5° of the French Commercial Code should be kept in mind, which punishes the abrupt termination of a contractual relationship. This means that the

notice period must be reasonable and will often increase with the duration of the relationship. Such termination without notice may be provided for but only in outstanding circumstances such as an act of God or the total breach of its obligations by the defaulting party.

The main advantage of the *clause de résiliation unilatérale* as compared to the *clause résolutoire* is that it offers the possibility to foresee any reason to terminate the agreement, without limitation. However, in case of dispute, French jurisdictions will be very careful when assessing whether the notice period is reasonable, whereas a notice period is not necessary in a *clause résolutoire*.

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