Date: 04.03.2004

Country: Arbitral Award

Number:

Court: Ad hoc Arbitration (Place unknown)

Parties: Unknown

KEYWORDS

DISTRIBUTORSHIP AGREEMENT BETWEEN WESTERN EUROPEAN MANUFACTURER AND CENTRAL EUROPEAN DISTRIBUTOR - FRENCH LAW GOVERNING THE CONTRACT – REFERENCE TO UNIDROIT PRINCIPLES IN SUPPORT OF SOLUTIONS ADOPTED UNDER FRENCH LAW

GOOD FAITH PRINCIPLE ACCORDING TO ARTICLES 1134(3) AND 1135 OF FRENCH CIVIL CODE RELEVANT ALSO IN INTERNATIONAL TRADE – ARTICLE 1.7(1) OF UNIDROIT PRINCIPLES

GOOD FAITH AND CONTRACT NEGOTIATION - PARTIES ENTERING INTO NEGOTIATIONS WITH A VIEW TO SETTLE DISPUTE BOUND TO ACT IN GOOD FAITH IN SEARCH OF AMICABLE SOLUTION – DUTY TO NEGOTIATE IN GOOD FAITH NOT BREACHED BY MERELY REFUSING TERMS OF SETTLEMENT PROPOSED BY OTHER PARTY

GOOD FAITH AND CONTRACT PERFORMANCE – DISTRIBUTORSHIP AGREEMENT PROVIDING FOR YEARLY MINIMUM QUANTITIES OF GOODS TO BE PURCHASED BY DISTRIBUTOR – DISTRIBUTOR'S FAILURE TO MEET YEARLY QUOTA – MANUFACTURER'S CLAIM FOR BREACH OF CONTRACT CONTRARY TO GOOD FAITH WHERE DISTRIBUTOR PURCHASED A SUBSTANTIAL QUANTITY OF GOODS IN EXCESS OF YEARLY QUOTA AT THE END OF PREVIOUS YEAR AND ITS FAILURE TO PURCHASE GOODS THE FOLLOWING YEAR WAS DUE TO DISPUTE WITH MANUFACTURER

CONTRACT PROHIBITING DISTRIBUTOR FROM SELLING SIMILAR PRODUCTS FROM OTHER SUPPLIERS – DISTRIBUTOR NEVERTHELESS SELLING COMPETING GOODS – MANUFACTURER AWARE OF IT BUT NOT OBJECTING PREVENTED FROM INVOKING YEARS LATER DISTRIBUTOR'S BREACH OF CONTRACT – PROHIBITION OF INCONSISTENT BEHAVIOUR A GENERALLY ACCEPTED PRINCIPLE IN INTERNATIONAL TRADE - ARTICLE 1.8 OF UNIDROIT PRINCIPLES 2004

ABSTRACT

Defendant, a Central European company, had been contractually granted the right to distribute in its own territory products from Claimant, a Western European firm. When Claimant entered into an alliance with a third party, it decided to cease manufacturing the products in question. On the assumption that Claimant would therefore no longer be in a position to deliver the goods for distribution, Defendant ceased its own performance. Claimant sued Defendant for damages.

The distribution agreement was governed by French law, but both parties and the Arbitral Tribunal referred to the UNIDROIT Principles in support of the solutions provided by French law.

The Arbitral Tribunal first of all rejected Defendant's claim that Claimant, by rejecting Defendant's proposals for an amicable settlement, had breached its duty to act in good faith as imposed by Articles 1134 (3) and 1135 of the French Civil Code as well as by the general principle governing international commercial relationships expressed in Article 1.7(1) of the UNIDROIT Principles.

The Arbitral Tribunal held that, though parties were under a duty to negotiate in good faith, the mere fact that Claimant did not accept the terms of settlement proposed by Defendant does not constitute a breach of such duty.

Yet the Arbitral Tribunal also rejected Claimant's allegations that Defendant had breached the distribution agreement. With respect to the argument that Defendant had one year failed to purchase the agreed minimum quantities, it was true that in the year in question Defendant had not placed any order at all; however since in the previous year Defendant had not only met the annual quota but at the end of that year had placed a further substantial order, it would be contrary to good faith for Claimant to invoke the lack of orders in the following year and to fail to take into account the substantial extra order made at the very end of the previous year, all the more so as Claimant had delivered the goods only months later. As to the allegation that Defendant had breached its contractually agreed obligation not to sell competing goods purchased from other manufacturers, the Arbitral Tribunal, while not denying the truth of the facts, held that Claimant had been prevented by its own conduct from accusing Defendant of breach of the contract. Indeed Defendant had already distributed those competing goods at the time of the conclusion of the contract and continued to do so afterwards and Claimant, though being perfectly aware of the situation, made no objections. To invoke Defendant's violation of its contractual obligation all of a sudden at this late stage definitely amounts to a case of inconsistent behaviour which, according to the Arbitral Tribunal, was contrary to a well established principle of international trade as confirmed by Article 1.8 of the 2004 edition of the UNIDROIT Principles.

FULL TEXT

A Central European company ("Central") had been contractually granted the right to distribute products from a Western European firm ("Western") in its own territory. When Western entered into an alliance with a third party, it decided to cease manufacturing those products. Central claimed this was preventing Western to continue to perform the distribution agreement and terminated its own performance. Western sued Central for damages. The Unidroit Principles were invoked in three different contexts, by the parties as well as by the sole arbitrator.

1. Central first invoked Western's alleged breach of good faith in the initial attempts to settle the dispute amicably :

"Respondent […] reproaches Claimant with refusing to negotiate in good faith the consequences of its alleged decision to stop commercialisation of (the products); "Indeed, rather than entering into a serious negotiation, Claimant denied that commercialisation had been disrupted, denied that any exclusivity had been granted to Respondent … and never seriously considered the loss suffered by Respondent by reason of this situation" … This attitude would be in breach of the good faith requirements imposed by articles 1134 par. 3 and 1135 of the French civil code, as well as by the general principle governing international commercial relationships expressed in article 1.7 (1) of the Unidroit Principles on international commercial contracts.

Claimant responds by stating that the fact that Respondent has re-sold the (products) bought under the Purchase Contract without paying their price "does obviously not constitute fair dealing in international trade"..."

For the Tribunal,

"The good faith principle expressed in articles 1134 par. 3 and 1135 of the French civil code is certainly also prevalent in international trade, as confirmed by article 1.7 (1) of the Unidroit Principles. When the dispute arose and parties entered into negotiations, both Claimant and Respondent were bound to act in good faith in search of an amicable solution. It turned out that the negotiation failed because of the excessive gap between Claimant's offer of price reduction … and Respondent's claim …

The mere fact that the parties did not agree on a compromise settlement does not in itself reveal lack on good faith on Claimant's side. (Western) saw no reason to grant large concessions on the remaining stock because it insisted that its (products) were still available … , a fact that has been found to be accurate ... Claimant's views on the scope of (a preceding agreement between the parties) may not be shared by the Tribunal … , but it had no apparent impact on the failure of the negotiations. Claimant's refusal to consider the different types of prejudice allegedly suffered by Respondent cannot certainly be considered as a breach of good faith since Claimant rightly denied that it was no longer in a position to perform its contractual obligations.

Consequently, the tribunal does not find that Claimant has breached the requirements of good faith during the negotiations that parties engaged into in order to reach an amicable settlement of their dispute".

2. Central had contractually undertaken to purchase yearly minimum quantities of the products. Central had already met its quota for 2001 when it purchased an important new quantity in November 2001, at a discount price. Due to the dispute, Central did not make any further purchases in 2002, leading Western to claim that the undertaking to purchase minimum quantities every year had been breached for that year. Should the November 2001 purchase be taken into account for 2002 ?

"Claimant claims … damages amounting to Western's loss of profit computed on the minimum purchase amount provided in the Distribution Agreement for … 2002 …

Respondent claims that the Minimum Purchase Agreement was achieved in 2002, since Central purchased equipment for ¤ 846,728 , plus a discount of ¤ 60,000, mostly in the context of the Purchase Contract (of November 2001) …
Claimant considers that the amount of (products) purchased under the Purchase Contract cannot be taken into account under the Minimum Purchase Agreement for 2002, since the Purchase Contract was executed on November 13, 2001.

On this point, the Tribunal cannot accept Claimant's position, considering the circumstances. The Purchase Contract was agreed upon late in 2001, after Respondent had already achieved a very successful year of commercialising (the products). Respondent claims that it had bought equipment for over ¤ 1,000,000 (while the Minimum Purchase Agreement for that year was ¤ 600,000). After Claimant denied the truthfulness of the statement … , Respondent submitted invoices in support of this assertion ... Whatever the precise figures of the 2001 purchases were prior to the Purchase Contract, it is certain that during that year Respondent had exceeded its quota. It will be recalled … that Claimant awarded Respondent a "Quota Breaker Award" diploma for "achieving an outstanding level of sales activity and customers satisfaction for year 2001" …

The Purchase Contract was executed in November 2001, when the Minimum Purchase Agreement for 2001 was already fulfilled. It concerned a large quantity of equipment, which amounted to ¤ 843,176 net, excluding VAT, i.e. almost the amount of the whole Minimum Purchase Agreement for the following year (¤ 900,000). Deliveries were to take place in December 2001, at a time when it was obvious that most of the purchases could no longer be sold to clients during that year. This was even more so as Claimant itself failed to deliver in time, and the last supplies on the Purchase Contract could only take place in May, 2002.

Under such circumstances, the Tribunal finds that it would be contrary to good faith (art 1134 al. 3 of the French Civil code, article 1.7 of the Unidroit Principles) to rely on the sole date when the Purchase Contract was executed to refuse to take it into consideration when assessing Respondent's achievement of the MPA for 2002".

3. The Distribution Agreement prevented Central from selling similar products from other

suppliers. However, it appeared that Central had never stopped selling the competing products it was selling before entering into the agreement, and that Western was aware of this situation. Before the Tribunal, Western claimed damages for breach of this undertaking. In a footnote to its decision, the Tribunal referred to the new article 1.8 of the Unidroit Principles.

"Claimant finally claims ¤ 100,000 as damages for the deterioration of Western's image on the … market, and ¤ 100,000 as damages for loss of profit, due to Central's alleged breach of its obligation not to sell competing products.

Article 4.4 of the Distribution Agreement provided that "Distributor agrees that it will not, during the term of this Agreement develop, manufacture, sell or promote, directly or indirectly, any equipment or device competitive with the Products constituting the subject matter of this Agreement, without a previous and specific authorization in writing from (Western)".

Claimant asserts than when visiting Central' warehouse in December 2002 …, it was discovered that the inventory was composed "of all possible … brands (of the products) present on the … market". On January 15, 2003, a constat d'huissier established that Central's website offered all kinds of … brands (of the product) to its customers.

Respondent does not deny that it had been selling competing products. It claims that Claimant did not suffer any prejudice from it, since in 2001, Central sold Western products well above the Minimum Purchase Agreement, while in 2002 and 2003, Western has decided to stop commercialisation of its (products) ...

In its written and oral testimonies, (Central's C.E.O.) also stated that Central had objected to article 4.4 when executing the Distribution Agreement, and had been assured that they were not requested to stop selling other brands; but the written confirmation Central had allegedly asked for never came …

In practice, (Western) knew that Central was a multi-brand wholesale company and Western never objected to this until the dispute arose. According to (Central's C.E.O.), Western even accepted to contribute to marketing actions and promotion made by Central in proportion to Western's share as compared to other products ...

The Tribunal finds that the fact that Central has been selling competing products is undisputed. However, the apparent prohibition provided by article 4.4 of the Distribution Agreement has to be put in context. As Claimant's counsel explained in its oral pleadings, when Western decided to improve its penetration in …, it approached Central because the latter firm was known as one of the top sellers on the market, already representing all major brands. Claimant knew from the start that Central was selling competing brands. If Claimant had really intended article 4.4 of the Distribution Agreement to be strictly enforced, it could have immediately verified that Central had terminated its relationship with other brands (e.g. by requiring a visit of Central's warehouse or checking Central's website in the early stages of the contractual relationship). No evidence is produced of such a concern before the dispute started.

On the contrary, (Central C.E.O.)'s assertion that Western contributed to the costs of marketing actions in proportion of its share as compared to other brands has not been denied by Claimant. This gives credibility to (Central C.E.O.)'s explanations about the assurances given to him that article 4.4 would cause no problem. Claimant's current reference to article 4.4 amounts to inconsistent behaviour, which is contrary to a well-established principle of international trade (cf. E. GAILLARD, L'interdiction de se contredire au détriment d'autrui comme principe général du droit du commerce international, Rev. Arb., 1985, pp. 241-2). [Footnote: The existence of such principle will be confirmed by article 1.8 of the 2nd edition of the Unidroit Principles, due to appear in 2004. According to this provision, « A party cannot act inconsistently with an understanding it has caused the other party to have and upon which that other party reasonably has acted in

reliance to its detriment »].

Consequently, the Tribunal does not admit Claimant's claims on this issue, relating to Western's alleged deterioration of image on the … market and loss of profit".

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