Invalidity of franchise providing for franchisor price-setting: implications in terms of restitution

(Supreme Court Judgment no. 1491/2014 of 11 November)

The age-old problem of whether Article 1303 or 1306 of the Civil Code applies to contracts in breach of competition law.

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1. Price-setting clause invalidity and restitution-related disagreements

The disputed franchise contract read as follows:

> Eighth: The franchisee may not freely apply prices but must follow those set by the franchisor. In addition, the franchisor reserves the right to change the prices as it sees fit, with effect as from the day after receipt thereof. Any positive or negative impact on the existing stock, as well as the cost of changing the pricelists or signage listing the prices, will be capitalised by the franchisee.

The franchisor sued the franchisee, making a claim for money on grounds of contractual liability, and requested that the franchisee be ordered to pay the amount of 12,000 euros, plus interest and costs. The basis of this claim was, in brief, that, after termination of the contract, the defendant had breached the non-compete undertaking

of clause 6 of the contract. The franchisee counterclaimed that it was the franchisor who had breached the contract and requested that the franchisor be ordered to pay the amount of 31,491.79 euros (the franchisee's investment), plus interest and costs. The basis of this counterclaim was an:

a) action for declaration of invalidity for breach of the statutory duty to transfer know-how;

b) action for declaration of invalidity for price-setting or exclusive-sourcing clauses;

c) action for declaration of invalidity for breach of pre-contractual and contractual duty of good faith;

d) action for declaration of invalidity for unlawfulness of the subject matter of the contract;

e) action to invalidate for vitiated consent; and

f) action for declaration of termination for breach.

The franchisee's statutory appeal was allowed by the Provincial Court, which reversed the trial judgment by upholding the counterclaim, not the claim. This appellate court concluded that it had been established that the franchisor unilaterally set product prices without guaranteeing the franchisee's commercial margin, as well as that the franchisor knew of the unlawfulness of such conduct. Therefore, in application of Article 1306(2) of the Civil Code ('CC'), the franchisor was ordered to pay compensation in the amount of 31,491.79 euros.

The Supreme Court upholds the franchisor's 'cassation' appeal against the above Provincial Court decision.

The second ground of appeal in cassation claims infringement of Article 1306(2) and non-application of Article 1303, both of the Civil Code, and infringement of judgments nos. 567/2009 of 30 July, 270/2017 of 4 May and 716/2016 of 30 November. In the explanation of the ground, the franchisor claims, in summary, that the appealed judgment contradicts the Supreme Court's case law, especially that settled in the aforementioned Judgment no. 567/2009, inasmuch as the inherent effect of contractual invalidity is the restitution of consideration. Neither the cause of invalidity is turpitude, in the strict sense of breach of good customs, nor the franchisor acted with a harmful or malicious purpose. The initial outlay made by the franchisee at the time was more than recovered and even a significant part of the assets of the business itself were reused in its new business.

In Judgment no. 587/2021 of July 28, also handed down in respect of a judgment of the same provincial court and in relation to a franchise contract of the same franchisor, the doctrine established in Judgment no. 567/2009 of 30 July was reproduced, citing the Judgment of the Court of Justice of the European Communities of 28 January 1986 *(Pronuptias)*, which declared that, if in a franchise contract there is price setting, such conduct is considered restrictive of competition, which is the same conclusion reached in a practically identical case by the appealed judgment. Regarding compensation, it was also indicated in Judgment no. 587/2021 of 28 July that, as a general rule, the case law of the Supreme Court

denies the applicability of Article 1306(2) CC to the invalidity of contracts as a consequence of infringements of competition rules and applies the generic provision on reciprocal restitution of consideration of Article 1303 of the same body of law[1]. In Community case law, the Judgment of the Court of Justice of the European Communities of 20 September 2001, C 453/99, *Courage*, established that, although the rule is that the party who creates the distortion of competition must compensate for the harm caused to the other party, it is not contrary to Community law to establish an exception in cases where the other party has also contributed with its actions to restrictions on or distortions of competition.

And, in our own case law, the aforementioned Judgment no. 567/2009 of 30 July, addressed this same problem in the scope of a franchise contract with price-setting by the franchisor. And it concluded that in these cases Article 1306(2) CC is not applicable, but rather Article 1303 CC, because "neither the cause of invalidity found has the condition of turpitude, in its strict sense of breach of good customs, nor has there been a harmful or malicious purpose on the part of the franchisor. The application of Article 1306 CC with the effect of 'leaving things as they are' would be clearly unjust, especially if it is taken into account that the inclusion of the clause is equally owing to both parties, and would entail a clear unjust enrichment for one of them". In this case there are the same circumstances as in the case tried by the aforementioned Judgments nos. 567/2009 of 30 July and 587/2021 of 28 July, so the conclusions must also be the same. The franchisee consented to the price-setting when signing the contract and during the term thereof and did not object to such issue until its economic discrepancies with the franchisor led to the termination of the contractual relationship. By virtue thereof, this second ground of appeal in cassation must be upheld and the reciprocal restitution of consideration must be ordered (pursuant to Article 1303 CC), so that the parties must mutually return to each other the things that were the subject matter of the contract, along with the proceeds and the price plus interest as of payment.

2. Evaluation of the outcome

Ultimately, it is not so much a question of whether Article 1303 or 1306(2) CC applies, so that in the latter case the franchisee does not return anything, but has the right to recovery of what has been given. It is a question, first, of whether the invalidity is total or partial, and the Supreme Court holds that it affects the entire franchise contract. If the invalidity is total, the Provincial Court's solution is not justified, because Article 1306(2) CC does not entitle the party *in bonis* to performance or compensation for the harm caused by the invalidity of the price-setting clause; it only entitles to recovery of what was given and to keep what was received. And this is not the problem at issue here (how could the franchised

[1] Supreme Court Judgments nos. 763/2014 of 12 January; 162/2015 of 31 March; 762/2015 of 30 December; 67/2018 of 7 February; and 135/2018 of 8 March.

trademark be kept!). The Supreme Court says that no compensation is due, but pure and simple and radical restitution by one and the other, because both parties were satisfied with the invalidity. It is not clear how the judgment of the Supreme Court imagines that the total restitution of Article 1303 CC can be made, which would mean that the franchisee would return the economic value of the use of the franchise enjoyed and recover the initial amount paid and the successive royalties paid. But who would keep the proceeds of the franchise, with the residual economic return obtained by the franchisee? Are not the proceeds of the franchise, at least in part, and in this part susceptible of restitution to the franchisor?

Strictly speaking, there are only two ways to solve this relationship: either Article 1306 CC is applied on the assumption that both are *in turpi causa* - this seems to be what the Supreme Court says - and nobody makes any restitution, in which case the *Courage* doctrine of the Court of Justice of the European Union is violated, or all restitution is waived, the invalidity of the contract or of the clause is declared (it would not matter) and the "less bad" party would be awarded compensation for malicious intent *in contrahendo* (wilfully not acting in good faith during negotiations) on the part of the franchisor, who caused the invalidity; in other words, what the Provincial Court did, but without resorting to the false niche of the aforementioned Article 1306 CC.