

Insights

BCLP PARIS – ANTITRUST AND DISTRIBUTION NEWSLETTER – JUNE 2022

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SUMMARY

The Egalim 2 law, which aims to improve farmers' income by maximizing the transparency of trade relations, came into force on October 18, 2021. Eight months later, its implementation is still largely imperfect, for reasons both endogenous, due to the complexity of the system, and exogenous, due to the war in Ukraine and the inflation of agricultural commodity prices.

OVERVIEW ON THE APPLICATION OF EGALIM 2 LAW

The Egalim 2 law ("**Egalim 2**"), which came into force on **October 18, 2021**, is the latest measure to restore balance to supplier/distributor relations in food distribution.

At the end of the trade negotiations for 2022 and in light of the inflationary effects of the war in Ukraine (II), it is appropriate to draw up a first assessment of the application of Egalim 2 (I) and to consider the future of the system (III).

MAIN CONTRIBUTIONS OF EGALIM 2

- The main objective is to improve farmers' income by increasing the transparency of all commercial relations in the food retail sector.
- The law provides a stricter contractual framework for contracts concluded between the various actors in the production chain:
 - At the level of the "upstream" relationship: **a contract with a minimum duration of three years including an automatic price revision clause must be concluded.**
 - At the level of the "downstream" relationship: **several mechanisms are put in place to prevent the distributor from negotiating the cost of agricultural raw materials.**

- News provisions strengthen the consumers' protection and, in particular their right to information.

AN IMPERFECT IMPLEMENTATION, DUE TO A COMPLEX SYSTEM

A material and geographical scope of application with poorly defined contours

The list of food products covered by Egalim 2 is based on a complex European customs nomenclature, which is made even more difficult to understand due to the exclusion of certain common food products, such as fruits, beverages (alcoholic or not), cereals, etc.

In addition, some products, such as flour, may be both included or excluded from the scheme, depending on the nature of the buyer. These inconsistencies make it very difficult for professionals, and in particular farmers, to understand the law as they are forced to juggle several sets of rules.

The law does not only apply to relations with retailers: some provisions concern suppliers and their "buyers". However, the notion of "buyer" covers hotels and restaurants in addition to distributors. It should be noted that the legislator has excluded wholesalers from the system, even though they represent the main pivot in the distribution chain.

The food products' origin is irrelevant. According to the Ministry of Agriculture, Egalim 2 must be interpreted as a police law applicable to food products manufactured abroad if there is a connection with French territory (such as the consumer's place of delivery, the buyer's place of business, etc.). This concerns both agricultural products delivered to France and products processed abroad and imported into France.

The foreign supplier will therefore have to comply with the provisions of Egalim 2 for its activities in France, as will the French supplier importing foreign food products.

The transparency mechanisms imposed by Egalim 2 do not have yet the expected effect

In order to allow value to flow back to the farmer, Egalim 2 provides for various mechanisms to limit the pressure of negotiations on agricultural raw material.

i. Between the agricultural producer and the first purchaser of the agricultural raw material.

To strengthen the transparency of "upstream" relations, Egalim 2 provides for:

- The obligation to conclude an annual written framework contracts for all sectors, with a minimum of three years duration (which can be extended to five years) ;

- The obligation to provide an automatic price revision clause based on indicators chosen by the parties.

Even if the law's intent is laudable, these new obligations weigh heavily on the farmer, who is now forced to propose a model contract to his buyer.

Sanctions for failure to comply with "upstream" obligations

Any failure to comply with these obligations may be punished by an administrative fine of a maximum amount equivalent to 2% of the turnover excluding tax of the last closed financial year.

ii. Between the food supplier and the distributor

Several mechanisms are designed to exclude the cost of agricultural raw material from the negotiable portion of the provider's rate:

In the T&Cs, the supplier shall either:

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- Be transparent by disclosing the share of agricultural raw materials in the food product sold (both in price and composition), for each of agricultural raw material in the product (option 1) or in aggregate, i.e., all agricultural raw materials combined (option 2);
- Have an independent third party certify that the agreement negotiated relative to year n-1 correctly reflects the increase in agricultural raw material costs (option 3).

At the end of the first months of application of Egalim 2, it appears that **the two "transparency" options have been abandoned in favor of the use of an independent third party** (option 3, favored by 70% of suppliers), for two reasons:

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- First, options 1 and 2 force the supplier to reveal, at least partially, the construction of its tariff to the distributor, which may limit its subsequent negotiating capacity. In addition, exercising these options forces the supplier to list, for each of its references, their exact share of agricultural raw materials in composition and price, which can be particularly complex (e.g. in the case of foreign manufacturing).
- Although it guarantees a certain "opacity" of the tariff, **option 3 is nonetheless difficult to implement**. Indeed, Egalim 2 does not specify which elements (and in particular whether or

not the cost of commercial cooperation services is taken into account) the third-party certifier must take into account in order to exercise its control. Let us hope that the first certifications issued by third-party certifiers (which are essentially the statutory auditors) will set a trend for the future.

The annual contract between the supplier and the distributor must state:

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- The "non-negotiable" portion of the agricultural raw materials in the tariff;
- The counterpart of each price reduction granted by the supplier to the distributor;
- **An automatic price revision clause based on changes in the cost of agricultural raw materials; and**
- A renegotiation clause in the event of an increase or decrease in the cost of agricultural products, but also in the cost of energy, transport and packaging.

The main innovation of the system is the automatic price revision clause, which is intended to avoid the need for the parties to return to the negotiating table during the year in the event of a significant change in the cost of agricultural raw materials. Its implementation raises several difficulties:

- The evolution of the indicators on which the revision formula is based is not necessarily correlated to the supplier's purchasing cycle. This can have the effect of "decoupling" the value of the agricultural raw materials inventory from its actual value;
- The adjustment formula must take into account both increases and decreases in the cost of agricultural raw materials. This implies that a supplier will be forced to mechanically lower its prices in the event of a drop in the price of the agricultural raw material it uses, even if it is exposed to increases in the cost of its other expenses (energy, transport, packaging, etc.);
- Some indicators do not exist, particularly in the so-called "organic" sectors, which has forced the co-contractors to postpone the integration of this clause to a later date.

Sanctions incurred in the event of failure to comply with "downstream" obligations

Failure to comply with these provisions is punishable by an administrative fine of up to €75,000 for a natural person and up to **€375,000 for a legal person, for each of the breaches identified.**

First DGCCRF sanction under Egalim 2

On February 22, 2022, ITM Alimentaire International (Intermarché) was fined of 19.2 million Euros by the DGCCRF.

The DGCCRF argued that ITM did not *"include in the annual agreements concluded with its suppliers the elements relating to commercial cooperation services invoiced by its international centers AgeCore (Switzerland) and ITM Belgium (Belgium), even though these services are provided in France"*.

The DGCCRF considered that ITM did not respect the "line by line" principle, which requires to show the counterpart of each price reduction granted by the supplier.

EGALIM 2 TESTED BY THE INFLATIONARY EFFECTS OF THE WAR IN UKRAINE

At the beginning of March 2022, trade negotiations on national brand products ended for the first time with **inflation accentuated by the crisis in Ukraine**. However, by excluding part of the supplier tariff from the commercial negotiations, **Egalim 2 also contributes to increasing food prices**.

Latest inflation readings

In France, inflation was estimated, at the end of May, to be of 5.2% over one year according to INSEE.

For consumer goods alone, the IRI Institute reported **an average price increase of 2.89%** in April 2022.

In this context, the government has set up a **monitoring committee for trade negotiations**, composed of representatives of the various links in the food distribution chain, to deal with the consequences of this crisis.

Signature of a commitment charter – not legally binding

On March 31, 2022, this committee led to the signing of a charter of commitment by representatives of large-scale distribution and their suppliers, providing for a whole series of commitments.

The supermarket retailers have committed to:

- **Activate the renegotiation clauses** (and *"to be flexible in the analysis of these clauses"*) in order to allow the increase in the price of energy and transport packaging to be taken into account, even if the criteria for opening renegotiation are not met; and

- **Not to apply the logistics penalties** if suppliers can justify sufficiently in advance the existence of a link between the delay and the war in Ukraine.

Suppliers commit to transparency and good faith when requesting price increases. In the event of a shortage, they must warn distributors as far in advance as possible in order to "*operate a fair distribution key*" of the resulting cost increase.

Sanctions in terms of logistics penalties are expected

At the beginning of the year, the DGCCRF concluded two investigations initiated during the previous round of commercial negotiations.

On the basis of these investigations, the DGCCRF indicated on February 23, 2022 to initiate an injunction procedure under penalty against a regional center of a retailer to stop its practices in terms of logistics penalties within three months.

The procedure relates in particular to the absence of proof sent to the supplier to establish the validity of the penalties. The supplier then issued automatic deductions equal to the amount of contested penalties.

In addition, the DGCCRF is carrying out reinforced investigations concerning logistic penalties with two other brands.

EGALIM IN THE FUTURE

The purchasing power of consumers seems to be at the heart of the concerns of the presidential campaign and the legislative elections.

However, by its very objective, Egalim 2 risks contributing to the increase of food prices in stores.

This phenomenon, coupled with the complexity of the system and the consequences of the war in Ukraine, may make the implementation of the system difficult. Let's hope that the application decrees and the future "guide to good practice" in terms of logistical penalties – the "Commission d'examen des pratiques commerciales" (CEPC) - will provide more details in the coming months.

BCLP – FOOD CAPABILITIES

Our team has expertise to advise on questions about Egalim 2. Indeed, the team is part of Bryan Cave Leighton Paisner's Food Law Group, which is composed of lawyers specialized in the food industry and present in more than 25 jurisdictions in the United States and Europe.

From the agricultural producer to the final consumer, our teams work on a national, European and international level with numerous players in the food industry.

Our attorneys have significant cross-sector experience in the food industry and assist companies in all matters relating to compliance with applicable regulations, litigation and acquisitions.

RELATED CAPABILITIES

- Antitrust & Competition
- Regulation, Compliance & Advisory

MEET THE TEAM



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