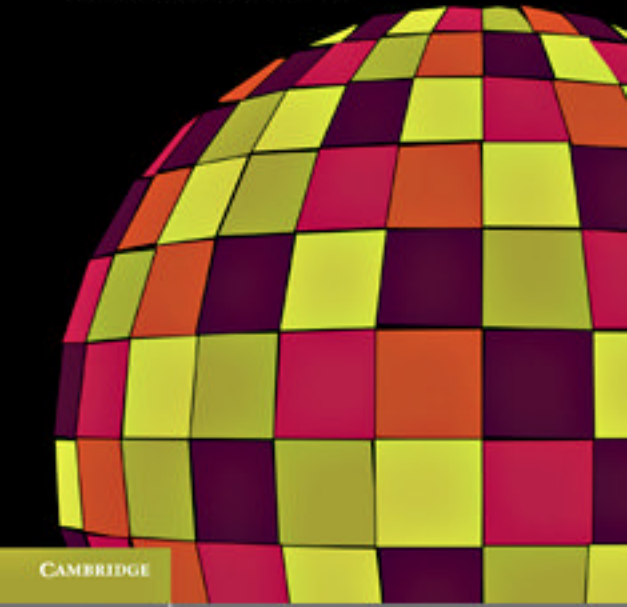
Boilerplate Clauses, International Commercial Contracts and the Applicable Law

EDITED BY
Giuditta Cordero-Moss



CAMBRIDGE

CAMBRIDGE www.cambridge.org/9780521197892

respect to compensation due to the seller's delay. They often spell out that the compensation amount shall be the *only* compensation, but if there is a considerable delay, the buyer shall also be entitled to terminate the contract. In some cases, there may be an option for the suffering party to choose either the agreed compensation or to demand damages, in which case the suffering party will have to prove his or her loss.

In all compensation clauses, there is a particular amount agreed with respect to the particular breach (a certain amount per day of delay, a certain amount per deficiency in speed, etc.), but the contract may also specifically provide that, in case the buyer is entitled to cancel the contract, no liquidated damages will be paid. The rationale for this is that a builder (in a construction contract) will make a considerable loss in case of cancellation and that the buyer should carry some of this burden.

Sales contract compensation clauses are most common in relation to delay in performance. In such cases, the contract normally prescribes that a certain amount shall be paid as compensation to the other party per day, per week or per other specified time unit of delay. In some contracts, a compensation clause with respect to other types of breach of performance may also be inserted. This is particularly the case where the obligation is precise, such as deficiency in a particular warranted quality or characteristic. Sometimes, the compensation clauses are standardised in a contract form, while in other cases, room is left open for the insertion of a certain amount, and in yet other instances, the parties will negotiate the compensation clause individually.

Compensation clauses are often agreed upon with respect to a positive obligation ('we undertake to deliver . . .'), but there are also instances where the compensation clause is agreed upon in relation to a negative undertaking ('we undertake not to disclose . . .'). The question may arise as to whether there is a principal difference between these types when it comes to their interpretation.

In contracts where a party sells a business, the M&A agreement often accompanies a prohibition for the seller to compete with the buyer within the same type of business for a certain period of time, with a compensation clause in case of breach.[45] In addition, in the event that a party has promised not to disclose information received during negotiations, such an undertaking may be underpinned by a compensation

[45] This may thus set out that if any information received during the negotiations is abused or disclosed to a third party, a certain amount shall be paid as a penalty.

clause.[46] Certain categories of employees may have a clause in their employment contracts prohibiting them from entering into new employment with a competing business until after a certain period of time. Often, such an undertaking is also coupled with a compensation clause. All these clauses thus cover negative undertakings. In these cases, it may be particularly hard to determine the damages to be paid.

The situation is different if, in connection with the sale of a company, it appears that the economic result of the company is less magnificent than was originally contemplated by the buyer (irrespective of the due diligence carried out). The contract may then set out that the seller will be liable up to a certain amount of the economic deficiency. Such liability will normally be valid only for a limited period of time.

Compensation clauses may thus be relevant both with respect to positive undertakings and negative undertakings. In the latter case, it is often very hard in practice to determine the amount of damages to be paid in case of breach of the undertaking, and the compensation amount is therefore often agreed upon depending on how the parties may agree on the financial effect of a breach.

There are some practical considerations with respect to the application of compensation clauses. Agreed compensation amounts with respect to positive undertakings often seem to be somewhat lower than damages that might be determined in the event of open-ended claims for damages.[47] The great advantage of compensation clauses is that the party claiming compensation will not have to prove that it has encountered a loss nor the amount of the loss, but if the prerequisites of the clause are met, then the amount will be paid out. However, this is also where there may be an argument against the application of the clauses by the party in breach, claiming that if there is no loss, then no amount should be paid. At least among Swedish arbitrators, there seems to be a tendency to uphold a compensation clause under such circumstances, and it is likely that Swedish courts will also, to a great extent, accept the compensation clause in such situations.

Another question may be whether a compensation clause shall be considered to be full compensation or whether the suffering party has a choice between using the compensation clause or instead going for full compensation according to general principles on damages, or whether

[46] There are several examples, among them negotiations in connection with patent licence agreements or other intellectual property agreements.

[47] This is, of course, a statement which has to be read carefully, since there are a number of situations where the agreed damages give a very good (and sometimes too good) cover.

they may be used in combination. Further, a question could be whether a compensation clause could be used even if the contract is terminated. Often, compensation clauses explicitly state that the only consequence of a breach shall be the agreed compensation. There shall be no further amounts payable and there shall also be no right of termination, unless the discrepancy between the agreed performance and the actual performance is substantial. For example, if there is a very long delay of, say twelve months, there may be a right of termination of the contract, but the right of compensation is then also cut off. The clauses in use are thus normally rather clear on these points.

There are no clear-cut cases in Sweden where courts have come to the conclusion that a deliberate breach of contract shall be treated in the same way if the contract contains a liquidated damages clause as if the contract contains a limitation of liability clause. The following can be used as an example. A Swedish building contract (general standard conditions – AB 2004) contains a provision on liquidated damages payable in case of delay on the side of the construction company. Let us assume that the construction company is offered another contract during the construction with a substantially better earning potential. Even if it would have to pay the full 'penalty' amount to the first buyer, the second contract would render a good profit. Would the construction company then be entitled to claim that they could just pay out the penalty amount and instead carry out the second project, possibly coming back to the first project at a later time?

There are different views on this in Swedish law. One approach is that the construction company in case of intentional breach may not rely on the compensation clause as a limitation amount. The other approach is that the agreed compensation shall be seen as the agreed amount to be paid for a breach.

If Swedish law treated compensation clauses as limitation of liability or exemption from liability, then compensation clauses would not be upheld in the event of intentional breach or gross negligence. Compensation clauses could also be regarded as an agreed compensation for a breach. How then would the difference between the two types of clauses be set out? Would there be a difference between compensation clauses covering positive or negative undertakings?

6.4 Delay interest

A particular item in this connection concerns the delay in payment. The payment debtor, as well as the performance debtor, has a duty to pay

within the time agreed. Failing this, there is a breach of his or her obligations and also certain consequences.

The DCFR prescribes in Article III – 3:708 on delay in payment of money:

(i) If payment of a sum of money is delayed, whether or not the non-performance is excused, the creditor is entitled to interest on that sum from the time when payment is due to the time of payment at the average commercial bank short-term lending rate to prime borrowers prevailing for the contractual currency at the place where payment is due.
(ii) The creditor may in addition recover damages for any further loss.

The contractual solution is often an agreed delay interest to be paid in case of delay in payment, but there may also be a particular provision entitling the counterparty to terminate the contract. Delay interest is normally set as a higher interest rate than that quoted as the current interest rate. Legislation in many countries has also often set out a rather high interest to be paid in case of delay in payment.

Delay interest is also a type of compensation clause. In the Nordic countries, particular legislation was introduced several years ago with the specific aim of allowing a high delay interest rate in order to induce debtors to pay in time. Currently, the EU Directive (2000/35/EL) prescribes that delay interest shall be paid in the event of delay in payment.

7 Conclusion

It is not easy to draw general conclusions from the above. Undoubtedly, there are differences between the Scandinavian approach and the interpretation and construction of contracts under English law, which is the original context of the examined clauses. There are also certain differences in approach between the courts in the various Scandinavian countries.

English and American contract practices have come to play a particular role in the drafting of international business contracts. Several different contractual solutions have developed over time that may apply in different phases of the contract (negotiations and performance), and contract draftsmen have introduced several different contractual clauses involving contracting, changes and amendments. Courts and contract draftsmen may not always share the same view on the binding nature of the contract. Whether a principle of good faith and fair dealing

may be used to set aside what the parties have agreed upon cannot be generally determined.

In recent Swedish case law, we have seen that a Swedish court will not only glance at other Scandinavian courts for guidance in the application of certain legal rules and principles, but may also take into consideration the development of English case law when determining the construction of a contract which has been drafted according to English law principles even though Swedish law is applicable. In addition, Swedish courts, to a growing extent, consider the various restatements of transnational principles (such as the UPICC, the PECL and the DCFR) when deciding cases under Swedish law.

So far, Swedish courts, in my view for good reasons, have been rather cautious in allowing the extensive use of § 36 of the Contracts Act in commercial relations. However, there has been some growing use of loyalty (good faith and fair dealing) reasoning during the last few years. Generally, two trends seem to have developed: on the one hand, a growing importance of English-American drafting technique and, on the other hand, a growing impact of legal reasoning emanating from European and international principles.

In order to sum up the Swedish aspects, a distinction could be made between boilerplate clauses that hardly have any contractual consequences in Swedish law and those that may have some legal implications. The former category will probably embrace clauses such as 'singular and plural', 'gender', '*pari passu*' and 'partial invalidity'. The second category embraces clauses which will have some, but not always absolutely clear, contractual impact:

Entire agreement: these clauses are common and have been judged in some cases. They have limiting effects on the freedom of a court to consider evidence. They will, however, hardly give rise to the creation of a parol evidence rule situation.

No waiver: the clause is not uncommon and will be given effect. In spite of the clause, the repeated behaviour of a party in contravention of it will probably as a consequence mean that it will lose its impact in the case.

No oral amendments: these clauses, which also serve to create contractual order, will be given effect, but if they are too formalistic, a court may decide to apply the clause somewhat less stringently.

Conditions: Swedish law does not recognise the traditional distinction in common law between conditions and warranties, but some

contractual provisions are regarded as rather more fundamental than others.

Sole remedy: this is a provision normally found in connection with liquidated damages clauses and is basically recognised.

Subject to contract: this is a type of clause which is also normally given effect in a contractual relation, but if applied in bad faith, a court may set the clause aside.

Material adverse change: this is a type of clause which is common in certain types of contracts. There is no Swedish case law concerning MAC clauses and it is hard to foresee their limits.

Liquidated damages: these clauses are very common in commercial contracts as a substitute for damages, and also possibly other consequences of a breach of contract. They will generally be given effect, but § 36 of the Contracts Act may be used to modify such a clause or even set it aside. In order for this to happen, the clause has to be regarded as very unreasonable in the circumstances at hand. Very often, a particular sole remedy provision will form part of the liquidated damages clause.

Indemnity, representations and warranties: there is no clear distinction in Swedish law between these types of clauses, but they will be understood and construed in accordance with their wording and the context in which they are used.

Hardship: there is no general exception for hardship events in Swedish law, but economic *force majeure* may be taken into consideration. Also, §36 of the Contracts Act may, under certain circumstances, be used to amend a contract with respect to hardship events. If there is a hardship clause in the contract, this will normally be recognised and upheld by a court.

15

The East European tradition: application of boilerplate clauses under Hungarian law

ATTILA MENYHÁRD

1 Introduction

Commercial law does not exist as a separate branch of law in Hungarian private law. Hungarian private law is built on a unified system where the Civil Code[1] covers the regulation of contracts, including the general framework and limits of freedom of contract for merchants as well as for other parties. As commercial contracts are neither defined nor covered by specific legislation, the Civil Code is to be applied to commercial contracts as well. There is specific legislation for contracts of foreign trade[2] providing more liberal regulation compared to the Civil Code, but the applicability of this law decree – still in force as one of the reminders of the socialist legislation – is in question, as in defining its scope it refers to the Foreign Trade Act, which is no longer in force. There is ongoing reform aimed at recodification of Hungarian private law, which would abolish this regulation discrepancy. The New Hungarian Civil Code – expected to come into force in about 2013 – would provide unitary (monistic) legislation and would cover commercial transactions as well.

As a main rule, the provisions of the Civil Code concerning the rights and obligations of the parties are default rules which become the content of the contract insofar as the parties did not agree otherwise. The paradigm of Hungarian contract law is freedom of contract, which necessarily implies that contract law rules are not mandatory. The non-mandatory character of regulation of contract law is provided in §200(1) of the Hungarian Civil Code, which explicitly provides that the parties to

[1] Act No. IV of 1959 on the Civil Code of the Republic of Hungary (Ptk.).
[2] Law-Decree No. 8 of 1977 on Application of the Civil Code in Foreign Business Relationship.

a contract are free to stipulate the content of their contract and that they shall be entitled, upon mutual consent, to deviate from the provisions pertaining to contracts insofar as such deviation is not prohibited by the law. Although sometimes it is not clear whether certain rules are of a mandatory character, one has to assume that provisions concerning contractual rights and obligations – insofor as not otherwise provided by the law – are of a non-mandatory character. Provisions of other types, like the definition of structural concepts of contract law (grounds and consequences of invalidity, termination, frustration, etc.) covering the construction of contracts or rules which entitle the court to intervene in the area of contractual rights and obligations of the parties (judicial amendment of contracts, judicial reduction of obligations of the parties, etc.), are mandatory rules which cannot be overruled by the parties. The same holds true for provisions that are implied as general clauses of the Civil Code, like the requirement of good faith and fair dealing.[3]

The central issue of dispute resolution in contractual relationships is the construction of the contract. The Hungarian Civil Code provides for a general norm concerning the construction of contractual statements by the parties. According to this rule, the contract is to be construed with regard to the assumed intent of the parties and the circumstances of the case, in accordance with the general accepted meaning of the words used in the contract. If the contract was concluded on the basis of standard contract terms or is a consumer contract, and if the meaning of a standard contract condition or the contents of a consumer contract cannot be clearly established by the application of the main rule of construction, the construction which is more favorable to the consumer or to the party entering into a contract with the person imposing such contractual terms or conditions shall prevail. Should a person waive his or her rights in part or in full, such a statement cannot be broadly construed. The parties' secret reservations or concealed motives will be irrelevant.[4] This rule of construction is to be considered mandatory, as it does not design and allocate the rights and obligations of the parties, but gives guidelines to the courts and other third parties concerning the construction of the contract.

[3] §4(1) of the Hungarian Civil Code. The general principles of private law (good faith and fair dealing, prohibition of abuse of rights, *nemo turpitudinem suam*) are covered by the introductory provisions of the Civil Code and are to be applied for all forms of private law relationships, including contracts.

[4] §207(1), (2), (4) and (5) of the Hungarian Civil Code.

The Hungarian arbitration and court practice in commercial dispute resolutions seem to tend to follow a flexible approach. As – in line with the non-mandatory character of regulation – normally the validity of undertaking contractual obligations in commercial law does not depend on compliance with normatively defined types, forms or categories of obligations, and covenants may have a valid cause even if they are atypical.[5] Thus, contractual obligations may be valid even if they do not correspond to normative types insofar as they do not violate mandatory rules or prohibitions in the regulation of contracts.

Imported contract clauses are widely used in Hungarian practice as well, mostly but not exclusively in transactions involving foreign investors. They still remain largely untested in Hungarian court practice. That is why analysing them can only rest on analysing the context provided by legislation and court practice. This makes the conclusions to be reached somewhat restricted or limited, especially where the result would depend on the standardised construction of typical clauses or where the starting points in court practice or regulation are completely missing. Although the clauses analysed here are to be held as enforceable on the basis of freedom of contract and parties are to be held as free in negotiating them, sometimes they may result in an unequal bargain which comes under the general control of private law and therefore may come up against the general limits of freedom of contract. It is not the aim of this chapter to give a detailed analysis of these situations. On the one hand, in commercial transactions on which this chapter focuses, these limits are relatively flexible and the courts would presumably be inclined to enforce the agreement of the parties as far as possible. On the other hand, such analysis would certainly go too far beyond the scope and limits of the aims of this chapter. The general tools for controlling unequal bargaining and preventing unacceptably unequal situations or abuse of rights in Hungarian private law are the general clauses of private law, especially the prohibition of abuse of rights and the requirement of good faith and fair dealing, as well as the grounds for invalidity of contracts contained in contract law regulation.

The requirement of good faith and fair dealing expresses the principle of mutual trust and shall be understood as a general standard of conduct set by the overall moral values accepted in society.[6] It is a general clause

[5] Supreme Court, Legf. Bír. Gfv. I. 33.312/1997. sz. – BH 1998. No. 440.

[6] A. Földi, *A jóhiszeműség és tisztességesség elve; intézménytörténeti vázlat a római jogtól napjainkig* (Publicationes Instituti Iuris Romani Budapestiensis fasc. 9, published by the

which, in its normative form, has been formulated among the introductory provisions of the Civil Code. It can and shall be applied in private law as a whole. Thus, the scope of the requirement of good faith and fair dealing shall not be restricted to contract law. The requirement of good faith and fair dealing is a fundamental principle underlying the private law in general. Its role and meaning is similar to that of *Treu und Glauben* in §242 of the German BGB. Article 1.7 of the UNIDROIT Principles of International Commercial Contracts and Article 1.106 of the Principles of European Contract Law formulate good faith and fair dealing as a fundamental principle to be applied overall within the scope of the Principles.[7]

At the heart of preventing and controlling unequal bargaining in contract law regulation lie the prohibition of immoral contracts (contracts contrary to public policy are to be understood as 'immoral' as well),[8] the prohibition of usury,[9] as well as the possibility of avoiding contracts with a striking imbalance between the performance and the counter-performance (§201(2) of the Civil Code)[10] and the control of standard contract terms.[11] The analysis provided here could not extend

Roman Law Department of ELTE Law Faculty, 2001), p. 90; and L. Vékás, in G. Gellért (ed.), *A Polgári Törvénykönyv Magyarázata* (Complex Kiadó, 2008), 4. §2.

[7] See the comments to Article 1.107 of the UNIDROIT Principles and the comments to Article 1.106 of the European Principles.

[8] §200(2) of the Hungarian Civil Code.

[9] Usury is a wide-ranging concept referring to excessive and abusive benefit. §202 of the Hungarian Civil Code provides that if a contracting party has stipulated a striking disproportionate advantage at the conclusion of the contract by exploiting the other party's situation, the contract shall be null and void (usurious contract).

[10] §201(2) of the Hungarian Civil Code provides the substantive justice in contracts. According to this provision, if, at the time of concluding the contract, there is a striking difference between the value of the two performances, without one of the parties having the intention of giving a gift, the aggrieved party is entitled to avoid the contract.

[11] As is provided in §209(1) and (2) of the Hungarian Civil Code, a standard contract term or a contractual term of a consumer contract which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith and fair dealing, it caused a significant and unjustified imbalance in the parties' rights and obligations arising under the contract to the detriment of the other contractual party entering into a contract with the person imposing such a contractual term or condition. The unfairness of a contractual term shall be assessed, taking into account the nature of the services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all the circumstances relating to the conclusion of the contract and to all the other terms of the contract or of another contract on which it is dependent. §209/A(1) of the Civil Code provides for the avoidability of unfair standard contract terms, while §209/A(2) makes them null and void in consumer contracts.

to all the possible aspects of limits of freedom of contract. Some of these grounds of unenforceability are referred to where the court practice, the regulation or the contracting situation in the context of the clause indicates its specific role and importance. It is, however, to be established in general that if the specific circumstances of the case call for the application of these norms and the limits of freedom of contract they imply, the otherwise-allowed contract clauses may be held as unenforceable in the given case and under the given circumstances.

2 Entire agreement

As far as defining the rights and obligations of the parties is concerned, such clauses are to be held as valid and enforceable between the parties on the basis of freedom of contract because they do not violate any mandatory rule. From this follows that, when the contract contains this clause, prior negotiations, representations, undertakings and agreements may not be held as part of the contract.[12] Conversely, if there are *lacunae* that require construction of the contract, such clauses could not prevent the judge from interpreting the contract – according to §207 of the Hungarian Civil Code – as it had to be understood by the other party. Thus, the contract can and is to be interpreted in the light of the previous statements, representations and undertakings of the parties.[13] The question of whether certain previously agreed specifications are to be held as parts of the parties' contractual obligations is to be answered according to the result of the interpretation. If the entire agreement clause is to be interpreted as excluding the application of these specifications, they are not to be held as part of the contract (although they may be implied by the court as gap-filling terms, e.g., as usual standards of quality in commerce). If that is not the case, these specifications may be referred to in the course of constructing the parties' assumed and expressed contractual will, as the parties may not restrict the courts in applying and interpreting the rules on construction of contracts, as is provided in §207 of the Hungarian Civil Code.

[12] This is suggested in the context of Hungarian private law as well by Kisfaludi: A. Kisfaludi, 'A teljességi záradék', *Gazdasági és Jog*, 11 (1995), 7.

[13] This conclusion is not only a logical consequence of interpreting the law, but is also the suggested solution for the New Hungarian Civil Code. L. Vékás (ed.), *Szakértői Javaslat az új Polgári Törvénykönyv tervezetéhez* (Complex Kiadó, 2008), p. 774.

3 No waiver

The Hungarian Civil Code does not provide that failure by a party to exercise a right or remedy should constitute a waiver thereof. Thus, it seems that such clauses neither amend the content of the contract to be implied by the provisions of the Civil Code nor affect the position of the parties under the governing law. However, in the absence of such a clause, the court may conclude that not exercising the right of termination within a reasonable time period constitutes a waiver of the right of termination on the basis of the requirement of good faith and fair dealing, or that referring to it would be an abuse of right which results in preventing the party from exercising the right.[14] If, however, the parties stipulated a no waiver clause in a commercial contract, normally there should be less room for the courts to imply limits concerning the exercising of this right on the basis of general clauses of the Civil Code, although such an implication of waiver, primarily on the basis of the requirement of good faith and fair dealing, may not be excluded. The general clauses of the Civil Code – among them the requirement of good faith and fair dealing or the prohibition of abuse of rights – are mandatory rules establishing implied obligations and requirements that the parties cannot contract out of. It follows from this that in the event that a no waiver clause is stipulated in a commercial contract, if, e.g., the contract gave the right to the party to terminate in case of delay in delivery and, in spite of the late delivery, the party did not terminate until after a considerable amount of time had passed, citing changes in the market, the termination is to be held basically as lawful, provided that the law or the contract allowed termination on this ground and the parties did not agree otherwise. The court, however, may come to the conclusion – especially if the delay in exercising the right might have created a protected interest (trust) of the party in breach – that exercising the right would be a violation of the implied duty of compliance with good

[14] A. Menyhárd, 'Protection of Legitimate Expectations in Hungarian Private Law', in B. Fauvarques-Cosson (ed.), *La Confiance Légitime et l'Estoppel* (Société de Législation Comparée, 2007), p. 278. A very recent development of court practice is that the court may reject the claim of the owner of a pre-emption right to enforce the contract concluded between the defendants if he or she knew that the defendants concluded the contract violating his or her rights but delayed enforcing his or her rights for a considerable time and could not provide acceptable explanation for this delay. Supreme Court, Legf. Bír. Pfv. VI. 20.492/2004. sz. – BH 2005 No. 320.

faith and fair dealing and may hold the termination, in spite of the no waiver clause, unlawful, barring the party from referring to it.

4 No oral amendments

§217(2) of the Hungarian Civil Code explicitly provides that the parties may agree that their contract shall be valid only in the agreed form. The form – including written form – is a precondition of validity of a contract if the parties expressly stipulated this. In such cases, however, the contract shall become valid by acceptance of performance or partial performance, even if a formal requirement had been stipulated but the parties failed to comply with it. Amendments to a contract, which are themselves contracts, are also to be covered by this provision of the Civil Code. It follows from this that no oral amendments clauses are valid under Hungarian law, and by such a clause an agreement on the amendment of the contract shall be valid in an oral form only if one of the parties accepted the – at least partial – performance of the other according to the orally agreed terms. The basis of this rule[15] is that if the party, in spite of the agreed form, accepted performance according to orally agreed terms, the performance from the one side and the acceptance of that on the other side shall be understood as mutual confirmation of the oral agreement. Thus, with performance and acceptance of performance, the parties set aside the agreed form by mutual consent.

On this ground, in the context of Hungarian contract law, it can be concluded that if the parties agree on an oral amendment, the party to the contract shall be entitled to refuse performance simply by invoking the no oral amendments clause and he or she could not be enforced to accept performance according to the orally agreed terms.

However, it is not clear whether the Hungarian courts would be inclined to construe the oral amendment – or a tacit agreement concluded by a conduct – as if the parties did set aside the no oral amendments clause by mutual consent. Such an interpretation – i.e., that oral agreement with mutual consent in spite of the no oral amendments clause implies agreement for setting aside the no oral amendments clause itself – could not be excluded in Hungarian contract law, although such a

[15] Motivation of the Draft for the Hungarian Civil Code of 1959, motivation to §217. *A Magyar Népköztársaság Polgári Törvénykönyve. Az 1959. évi IV. tv. és a javaslat miniszteri indokolása* (Közgazdasági és Jogi Könyvkiadó, 1963), p. 242.

conclusion has not been confirmed, up to now, in Hungarian court practice.

5 Severability

There is a general provision provided in the Hungarian Civil Code for partial invalidity. As it is provided in §239 of the Hungarian Civil Code for non-consumer contracts, in the event of partial invalidity of a contract, the entire contract shall fail only if the parties would not have concluded it without the invalid part. As far as consumer contracts are concerned, in the event of partial invalidity, the entire contract shall fail only if the contract cannot be performed without the invalid part. There is no specific rule in Hungarian private law providing that the invalidity of certain contract terms renders the whole contract invalid. Thus, the severability clause does not seem to conflict with the regulation and is to be construed as if the parties declared that none of the terms and conditions of their contract should be considered to be so fundamental that they would not have contracted in the event of its unenforceability. The rule provided in §239 of the Hungarian Civil Code seems to be open enough to allow the parties to define clauses whose invalidity shall lead to the invalidity of the entire agreement. If the severability clause resulted in an unbalanced contract, that will be controlled with general clauses (such as the invalidity of contracts contrary to good moral public policy) of the Civil Code or with other grounds of invalidity. If, e.g., the severability clause in standard contract terms or in a non-individually negotiated consumer contract is unfair, it is unenforceable.[16]

6 Conditions

'Fundamental breach' is not listed in the Hungarian Civil Code as a ground for termination of the contract. Generally, breach of contract

[16] According to §209 of the Hungarian Civil Code, a standard contract term or a contractual term of a consumer contract which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith and fair dealing, it caused a significant and unjustified imbalance in the parties' contractual rights and obligations to the detriment of the party entering into the contract with the person imposing such a contractual term or condition. The unfairness of a contractual term shall be assessed, taking into account the nature of the services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all the circumstances relating to the conclusion of the contract and to all the other terms of the contract or of another contract on which it is dependent.

has consequences like overdue interest, damages, agreed penalties, etc. At the centre of defining cases of breach of contract which provide a ground for termination by the aggrieved party is the concept of frustration of interests in performance.

In the event of delay, the obligee shall be entitled to terminate the contract if his or her interests in performance have been frustrated. The obligee shall be entitled to terminate the contract in the absence of proving the frustration of his or her interests in performance if, according to the agreement of the parties or due to the imminent purpose of the service, the contract had to be performed at a definite time and no other, or if the obligee has stipulated a reasonable peremptory term for the delayed performance and this period elapsed without result.[17] This means that in the context of delay, the parties are free to stipulate the undertaken deadline as a fixed one giving the right to the obligee to terminate the contract on the sole ground of missing the deadline; otherwise, the frustration of interest must be proven or an adequate peremptory period must be given to, and again missed by, the obligor as a prerequisite of termination.

In the event of defective performance, the obligee shall be entitled to terminate the contract if he or she was entitled to neither repair nor replacement, or if the obligor refused to provide repair or replacement, or was unable to complete the repair or replacement within a reasonable period of time and without any significant inconvenience, taking account of the nature of the goods and the purpose for which the consumer required the goods. The obligee shall not be entitled to have the contract terminated if the defect is minor.[18]

Thus, a clause saying simply that certain obligations are fundamental and any breach thereof shall amount to a fundamental breach of the contract has no meaning in the context of Hungarian contract law. In general, however, parties are free to provide grounds of termination in the contract according to their mutual will. Freedom of contract includes the freedom to design rights of termination and provide the prerequisites for exercising these rights in the contract. Thus, parties are free to stipulate that a fundamental breach is a basis for termination and they are free to define fundamental breach or to circumscribe the situations to be qualified as a fundamental breach. If they agree that the aggrieved party shall be entitled to terminate the contract if the other party breached the contract and the breach is a fundamental one

[17] §300 of the Hungarian Civil Code. [18] §306 of the Hungarian Civil Code.

according to the contract, this agreement shall be enforceable. In this context, if the parties agreed that a fundamental breach is a ground for termination and the contract defines delay in delivery as a fundamental breach, this shall be enforceable as well. If the delay occurred, it means that the agreed prerequisite of an agreed remedy (i.e., termination) occurred and this shall give the right to the other party – independently of the actual consequences of the delay – to terminate the contract. With such an approach, termination may be seen not as a remedy but simply as a right given to the party for a condition (delay) that has been fulfilled. As in the contract the party undertook the risk of termination in case of delay, in commercial relationships, the courts presumably would not consider if it was an abuse of rights or incompliance with the requirement of good faith and fair dealing to exercise the right in the absence of any adverse consequences, but because, e.g., the market has changed and the contract is no longer profitable.

To sum up, in the context of Hungarian contract law, there is no point in defining contractually which breaches are to be deemed fundamental as regulation does not attach any consequences to fundamental breach. The parties are, however, free to give the right of termination to each other and may describe the prerequisites of exercising the rights or the cases and situations when the right of termination may be exercised, including defining cases of fundamental breach and giving the right of termination in these cases. If the right of termination provided to the parties or to one of the parties resulted in an imbalance between the rights and obligations of the parties, is abusive or does not comply with the requirement of good faith and fair dealing, the general tools for control of enforceability of a contract are to be applied. The right of termination in this case – as with the content of the contract – is a negotiated right provided to the party. If the negotiated prerequisites are fulfilled and have opened up the possibility of exercising the right, the clause should be enforceable, regardless of the real reason for exercising the negotiated right. In commercial relations, courts would presumably be reluctant to go into the real motives of conduct if the parties themselves defined the conduct as lawful.

7 Sole remedy

A sole remedy clause restricting the party's remedies to liquidated damages is a limitation of liability for breach of contract in two ways. On the one hand, it deprives the aggrieved party of other remedies provided by

the regulation, such as claiming that the contract should be enforced in kind,[19] the right to terminate the contract, claiming overdue interest (if the missed obligation is paying a sum) or, if applied in the context of defective performance, of repair or replacement. On the other hand, it limits the liability for damages to a certain negotiated sum even if the suffered loss exceeded the agreed amount.

Both ways of limitation of liability fall under the application of §314 of the Hungarian Civil Code, which provides the limits for exclusion and limitation clauses. According to this provision, the liability for breach of contract – insofar as it is not explicitly prohibited – can be excluded or limited only if the disadvantage of limitation of liability was compensated by an adequate reduction of the price or other countervalue, or by providing another benefit. Liability for breach of contract caused deliberately, by gross negligence or by crime, or which caused damage to life, health or physical integrity cannot be validly excluded. The provision shall not be applicable in foreign commercial relations of Hungarian companies falling under a special regime of Law Decree No. 8 of 1978 (§15). Thus, a sole remedy clause in the context of the application of the Hungarian Civil Code shall be held enforceable if it has complied with the two-step test of §314 of the Hungarian Civil Code: first, the breach of contract was not grossly negligent, was not a crime, was not deliberate

[19] §277(1) of the Hungarian Civil Code provides that contracts shall be performed as stipulated at the place and in the time set forth and in accordance with the quantity, quality and range specified therein. This provision of the Civil Code underlies one of the basic principles of the rules of performance which may be called the principle of 'real performance'. The general rule of the Civil Code is specific performance and this is expressly provided in §300, which regulates the consequences of a breach of contract when the breach consists of a delay in performance: if the party to the contract fails to perform his or her obligation as it falls due, the aggrieved party shall have the right to claim performance of the contractual obligation. Monetary compensation (damages) shall replace enforced performance only if the performance in kind is impossible or if it would be against the interests of the creditor. The general principle of enforced performance is supported by other provisions of the Civil Code as well. It follows from the provisions and the structure of the rules covering the remedies for breach of contract in Ptk. that if the performance becomes impossible, the party who was responsible for it shall be obliged to pay damages to the other party. This means that impossibility excludes specific performance. If performance is possible but the debtor is in delay, the creditor has the right to demand enforced performance or to repudiate the contract (§300), and if the debtor refuses to fulfil his or her obligation, the creditor may choose between the consequences of delay (demanding enforced performance) and the consequences of impossibility (§313) (i.e., claiming damages instead of specific performance). If the contractual obligation of the party is providing a declaration, the court may rectify it with its judgment (§295).

and did not cause damage to life, health or physical integrity; and, second, the disadvantage of the exemption clause was compensated for by the adequate reduction of the price or other countervalue, or by providing another benefit. It seems to be generally accepted that the compensation – the price reduction or any other benefit – must be proportional to the detriment deriving from the exemption clause. The proportionality must be assessed *at the time of the conclusion of the contract*, according to the ratio of the compensation and the risk deriving from the exemption clause (it should not be assessed after the breach of contract, according to the ratio of the caused damage and the given compensation).[20] The adequate compensation not only can be provided as a price reduction, but also in the form of any other benefit. In a chain of contracts or in special constructions like a financial lease, the assignment of the rights from remedies can also be an adequate compensation.[21] The solution, making the enforceability of exclusion clauses dependent on providing adequate compensation, has been strongly criticised in the Hungarian literature. It has been argued that adequate reduction of the counterperformance could provide a proper result only if the value of the counterperformance would be objectively determinable, which is normally not the case. Since the stipulation of the price is up to the parties, the test of adequate compensation can easily be evaded by formally setting a higher price and ostensibly 'reducing' it to the amount that the seller originally wanted to get for the goods.[22] In cases of defective performance, it is widely accepted that the compensation is adequate if the price is reduced to the value of the defective good but if the defective good's value remains much lower than the reduced price, the exemption of liability is unenforceable.[23]

If it is assumed that parties with equal bargaining power consented freely and consciously to clauses drawing the boundary of their liabilities, there does not seem to be a reasonable ground for distinguishing between definition clauses and exemption clauses. This would limit the parties'

[20] F. Petrik, *Szavatosság, jótállás és fogyasztóvédelem* (Közgazdasági és Jogi Könyvkiadó, 1995), p. 24.

[21] E.g., in a financial lease, the lessor can validly exclude his or her liability regarding the subject of the lease if he or she assigns his or her rights against the supplier to the lessee if the assignment provided real and complete compensation for the disadvantage. See, e.g., the opinion of the County Court of Csongrád No. 3 of 2000, 21 June 1996.

[22] A. Kisfaludi, *Az adásvételi szerződés* (Budapest: Közfazdasági és Jogi Könyvkiadó, 1999), p. 205.

[23] Petrik, *Szavatosság*, p. 24. See also Gellért, *A Polgári Törvénykönyv Magyarázata*, §314.

freedom of contract in spite of the non-mandatory character of contract law. In commercial transactions, regulatory limitations on exclusion clauses – like §314 of the Civil Code in Hungarian law – restrict the freedom of the parties to agree upon lump-sum damages, making the boundaries of the obligation undertaken as the result of the bargain clear. This is also a question of pricing: the price the party would ask for his or her performance is normally adjusted to the risk imposed on him or her by the law and by the contract. Statutory restrictions on exclusion clauses also restrict the playing field of the parties for the bargain, as this way the law simply prevents the parties from agreeing freely regarding the risks to be undertaken for the agreed price. In commercial transactions, this does not seem to be reasonable and this led the Hungarian legislator to abandon this restriction (i.e., requiring an adequate price reduction as a prerequisite of the enforceability of exclusion clauses) in the New Civil Code, at least as far as damage to property was concerned.[24]

Thus, the enforceability of sole remedy clauses depends on the compensation provided for the disadvantage it creates. Providing adequate compensation can make the sole remedy clause enforceable concerning both restricting the available remedy to the liquidated damages and the limitation of liability to the agreed sum as liquidated damages. In the absence of adequate compensation, in cases of personal injury or if the breach of contract was a result of gross negligence, deliberateness or crime, the sole remedy clause is unenforceable. If the sole remedy clause had not been made enforceable by adequate compensation, the aggrieved party may claim full compensation and may exercise all the rights he or she is provided by regulation irrespective of the sole remedy clause and liquidated damages.

8 Subject to contract

In Hungarian legal doctrine, a contract is the result of the mutual expressed will of the parties to create legally binding promises. Whether the contract is concluded between the parties depends on the construction of their expressed will in the course of the contracting process. If, according to the rule of construction (§207 of the Hungarian Civil Code), the conclusion of contract as an exchange of legally binding promises cannot be established, there is no contract between the parties.

[24] L. Vékás (ed.), *Szakértői Javaslat az új Polgári Törvénykönyv tervezetéhez* (Complex Kiadó, 2008), p. 818.

The parties may bind themselves to conclude a contract with a certain content, but such a 'preliminary' contract must also be concluded with a mutual consent of undertaking the legally binding obligation to make a contract in the future. If the parties expressed their intent to conclude a contract without expressing that they hold themselves as legally bound to do so, such an expression of intentions cannot create contractual rights and obligations between the parties. Hungarian court practice and regulation make a clear distinction between expressing intent without making legally binding promises to contract, the 'preliminary' contract creating legally enforceable obligations for the parties to conclude the contract and the contract itself. Expressed intent to contract does not create legally binding obligations and cannot be enforced either as a contract or as a preliminary contract. On the basis of letters of intent, neither the obligations to be undertaken in the final contract (e.g., payment or performance of other contractual obligations)[25] nor the conclusion of a contract according to the letters of intent can be enforced.[26] If the parties agreed to conclude a contract in the future, they are obliged to conclude the contract with the agreed content according to their preliminary contract. If a party refuses to conclude the (final) contract on the basis of the preliminary contract, the court shall – on the basis of the claim of the aggrieved party to the preliminary contract – create the final contract and determine its content with the judgment.[27] Letters or

[25] Supreme Court, Legf. Bír. Gfv. X. 30.072/2002. sz. – BH 2003. No. 203, Supreme Court, Legf. Bír. Pfv. VIII. 22.912/1996. sz. – BH 1998. No. 229.

[26] §295 of the Hungarian Civil Code under enforcement of contracts – as a normatively provided method of specific performance of contractual promises – makes it possible to substitute the legal acts that a party was contractually obligated to make with a court decision. Under this rule, however, Hungarian court practice substitutes only declarations undertaken in a contract but not on the basis of a letter of intent. Court practice seems to be consequent in rejecting such claims on the basis of a letter of intent or other declaration of an intent. Supreme Court, Legf. Bír. Pfv. VI. 22.060/2006. – BH 2007. No. 368, Regional Court of Budapest, Fővárosi Ítélőtábla 7. Pf. 21 108/2003/5. – BDT2004. No. 1011.

[27] The court shall also be entitled to establish a contract if the preliminary contract does not contain an agreement concerning the key issues of the contract, provided that, in due consideration of the interests of the parties and the national economy, the content of the contract can be determined on the basis of the parties' negotiations and pre-existing contracts, and all of the circumstances of the case. Under special circumstances, the court may bring a contract into existence by modifying the terms specified in the preliminary contract if it is justified by the interests of the national economy or any interest of the parties deserving special consideration. Either party shall be entitled to refuse to conclude a contract if it provides proof of inability to perform the contract by virtue of a circumstance that has occurred after the conclusion of the preliminary contract or if the performance of the contract would be detrimental to the national economy, or if, on the

other forms of declaration of intent do not in themselves create a preliminary contract.[28] In order to establish that a preliminary contract is concluded between the parties, it is necessary to express a contractual will of entering such a contract and exchanging legally binding promises to conclude the final contract at a certain point of time in the future. Expressing intents is certainly not enough to establish this.

Thus, a letter of intent or the parties' mutual declaration that a document signed by them does not represent a binding agreement between the parties and that neither party shall be under any liability to the other party in the event of failure to enter into the final agreement cannot, in Hungarian law, create legally binding promises between the parties and cannot be enforced as a contract.

However, this does not mean that the trust created by the party by such an expression of intent cannot establish legally protected interests and that the party cannot be held liable for the legitimate expectations he or she induced. Either the general rules of liability in tort or a specific provision of the Hungarian Civil Code (§6) may establish an obligation to provide compensation for a frustrated trust.

The basic norm of liability in tort is provided by §339(1) of the Hungarian Civil Code, which establishes that if a person caused damage to another unlawfully,[29] he or she shall be liable for that and can exonerate himself or herself from liability by proving that he or she acted as would be generally expected under the given circumstances. Hungarian tort law regulation is a system of open rules which provides the courts with great power and allows them to establish and use the proper guidelines to assess tort cases. Accordingly, Hungarian tort law as a law in action is a flexible system.[30] The result of this system is that a large part of the Hungarian tort law is

basis of such a circumstance, avoidance or termination of the contract might apply. Concerning other issues, the provisions pertaining to a contract to be concluded on the basis of an agreement in principle shall be duly applied regarding the preliminary contract (§ 208 of the Hungarian Civil Code).

[28] Supreme Court, Legf. Bír. Pfv. V. 20.261/1995.sz. – BH 1996. No. 421.

[29] Unlawfulness is a wide-ranging concept in Hungarian tort law and does not infer wrongful interference with protected interests defined or circumscribed by the law. Although courts often try to find a certain legal norm which had been interfered with by the tortfeasor in order to establish liability, this would not be a necessary requirement of liability. G. Eörsi, *A polgári jogi kártérítési felelősség kézikönyve* (1966, Közgazdasági és Jogi Könyvkiadó), No. 221.

[30] For the concept of a flexible system, see W. Wilburg, *Entwicklung eines beweglichen Systems im Bürgerlichen Recht* (Rede gehalten bei der Inauguration als Rector magnificus der Karl-Franzes Universität in Graz am 22 November 1950, 1950) and *Zusammenspiel der Kräfte im Aufbau des Schuldrechts* [163 AcP (1964)], p. 364.