Boilerplate Clauses, International Commercial Contracts and the Applicable Law

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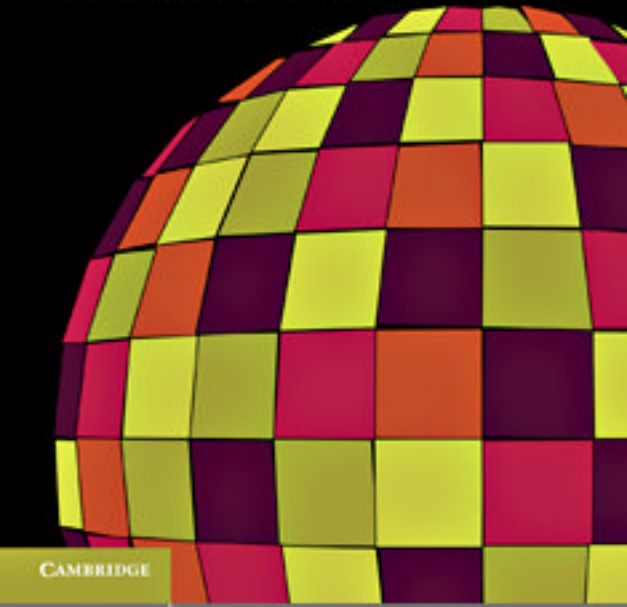

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other forms of declaration of intent do not in themselves create a preliminary contract.[28] In order to establish that a preliminary contract is concluded between the parties, it is necessary to express a contractual will of entering such a contract 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.

judge-made law built upon a complex system of criteria to assess and decide tort law cases and to draw the boundaries of liability. The basis of liability under §339(1) of the Hungarian Civil Code is fault, where fault is a conduct which did not meet the requirement of general required conduct, i.e., generally expected behaviour in the given circumstances. In this flexible system, the court may establish the liability in tort of those who falsely create an expectation or an appearance. Hungarian courts most often choose fault-based tort liability to provide compensation for victims of falsely created expectations. Since not only the concept of fault but also causation are very open concepts in this system, the indirect nature of causation does not preclude establishing liability of the tortfeasor for frustrated expectations.

§6 of the Hungarian Civil Code provides a specific norm and basis of claims for compensating damage suffered by induced conduct and created expectations. According to this specific provision of the Hungarian Civil Code, someone who with intentional conduct induced another person in good faith and with good reason to act in a certain way may be held fully or partly liable to compensate that person for the damage he or she suffered through no fault of his or her own because he or she relied on the inducement of the former. This provision of the Civil Code establishes an obligation that is not based on liability: neither fault on the defendant's part nor the unlawfulness of their conduct is a precondition of the obligation to compensate the victim. The rule aims at protecting reliance interests – just like estoppel in common law systems – and allocating the risk of the plaintiff's conduct. §6 of the Hungarian Civil Code provides a general remedy for suffering harm as a consequence of reliance on the conduct of another. The provision is very specific from a theoretical as well as from a practical point of view. The theoretical starting point of the legislator was providing a remedy for the consequences of behaviour which is neither unlawful (unlawfulness would establish liability in tort) nor lawful (lawful behaviour shall not be sanctioned) and does not consist of a breach of a contractual promise. It follows from this that this provision cannot be applied if the conduct triggers liability in tort or establishes liability for breach of contract. In such a case, the victim is entitled to remedy in tort or breach of contract. The conduct on which the aggrieved person relies is neither prohibited, nor does it express contractual will.[31] The conjunctive prerequisites of

[31] Motivation to the Bill of the Act of IV 1959 on the Civil Code of Hungarian Republic, p. 39. See also T. Lábady, *A magyar magánjog (polgári jog) általános része*, 3rd edn (Dialóg Campus, 2002), p. 304.

responsibility for such behaviour under §6 of the Hungarian Civil Code are: intentional conduct (which does not necessarily aim at influencing the behaviour of the aggrieved person);[32] the aggrieved person acting in good faith; the aggrieved person acting in good faith relying on the conduct and that conduct inducing him or her – with reasonable justification – to act;[33] the aggrieved person suffering harm as a result of his or her own conduct induced by the other; and the aggrieved person suffering harm through no fault of his or her own.

These prerequisites do not necessarily establish the obligation of the person to compensate the aggrieved person: according to §6 of the Hungarian Civil Code, the court *may* oblige the person inducing the other to act to compensate fully or in part the aggrieved person, who suffered harm. The court has wide discretionary powers to decide whether to order compensation or not at all and, if it does so, to what extent the aggrieved party's loss shall be compensated.[34] The Hungarian court practice seems to be restrictive in the course of the application of §6 of the Civil Code. Courts consequently reject the claims based on §6 of the Civil Code if a contract exists between the parties,[35] even if this would not follow from the norm itself. There is a general tendency for courts to apply this specific provision as a means of risk allocation – which reflects the actual function of the provision – and to be reluctant to shift the risk of one's own act to another person. The general approach, which has been reinforced in the Supreme Court's guidelines relating to economic cases,[36] is that an enterprise basically shall bear the risk of its own activity. If an enterprise fails to foresee the possibility that an event that falls within the definition of a normal business risk might occur, it may not argue that it relied on the assumption that the event would not occur in order to claim the fulfilment of the other party's performance. In such a case, the fault of the aggrieved party excludes the compensation under §6 of the Civil Code.[37] This is also the case for reliance on information provided by the other party. In commercial cases, the starting

[32] Actually, it is not clear what the scope of the intent of the person should be in order to establish the application of §6 of the Hungarian Civil Code.

[33] There must be a causal link between the conduct and the acting of the aggrieved party. Supreme Court, Legf. Bír. Pfv. V. 22.772/1995. sz. – BH 1997. No. 275.

[34] K. Benedek and M. Világhy, *A Polgári Törvénykönyv a gyakorlatban* (Közgazdasági és Jogi Könyvkiadó, 1965), p. 38

[35] Supreme Court, Legf. Bír. Pf. I. 20 157/1992. sz. – BH 1992. No. 385.

[36] Legfelsőbb Bíróság GK 14. sz. gazdasági kollégiumi állásfoglalás (Supreme Court, Statement No. GK. 14 of the College for Commercial Cases).

[37] Supreme Court, P. törv. I. 20 289/1985. sz. – BH 1986. No. 319. G. Légrádi, Az utaló magatartás (biztatási kár) a Ptk.-ban és a bírói gyakorlatban, *Polgári Jogi Kodifikáció* 2003/4, p. 22.

point is that even if the party has been induced by another's representation, the consequences of its acts shall remain within its own risk.[38]

Thus, if the parties entered into a letter of intent specifying that failure to reach a final agreement will not expose any of the parties to liability, there is no legally binding promise between the parties on the basis of the letter of intent. The risk that the other party fails to adhere to the expressed intent shall be regarded as the business risk of the aggrieved party. If, however, it turned out that one party never really intended to enter into a final agreement and used the negotiations only to prevent the other party from entering into a contract with a third party, this is not considered to be part of the business risk of the parties. In such a case, the aggrieved party may claim compensation for damages on the basis of tort law or §6 of the Hungarian Civil Code, which provides compensation for induced and frustrated reliance.

9 Material adverse change

Establishing conditions precedent to closing should be construed as an atypical enforceable agreement between the parties. Such agreements – although not typical – are not incompatible with the regulation of contracts provided for in the Hungarian Civil Code, and there is no ground to hold them as invalid. As the agreement on conditions precedent is enforceable, the party shall be entitled to invoke the clause to avoid a deal if any of the circumstances circumscribed in the conditions precedent occurred. As in the case of a legal dispute, the burden of proof concerning the occurrence of the referred circumstance is shifted to the person relying on this; the party invoking the clause has to prove that the event referred to actually did occur. The risk to be borne by the party invoking the clause is that it will be the subject of an *ex post* evaluation if it got out of the transaction lawfully or if it is in breach of the contract. From this point of view, the evaluation of the party seems to be irrelevant – the question would be whether the change in external circumstances giving the right to the party to avoid concluding the contract actually did occur.

10 Liquidated damages

In commercial contracting practice, parties usually try to standardise the compensation the obligor has to pay in the event of breach of contract. By

[38] Supreme Court, GK 14.

doing so, they try to make their obligations foreseeable and pre-estimate the undertaken risk. Liquidated damages in Hungarian contract law are not a regulated remedy. A penalty is the typical regulated remedy for breach of contract provided by contract law regulation. Penalty clauses have a double function, as they provide lump-sum compensation to the aggrieved party and also provide a repressive sanction in the event of breach of contract, even in the absence of damage, in order to enforce the party to perform if breaching the contract would be more efficient for him ot her. A penalty in Hungarian contract law is a contractual secondary obligation. According to §246 of the Civil Code, under a penalty clause stipulated in the contract, the obligor has to pay a certain sum of money if he or she failed to perform the contract or if his or her performance does not conform with the contract for reasons attributable to him or her (default penalty). The payment of a penalty does not relieve the party of his or her contractual obligation because, according to §246(2) of the Hungarian Civil Code, the obligor shall be entitled to claim damages exceeding the penalty as well as enforcing other rights resulting from a breach of contract (however, by claiming a default penalty, he or she loses the right to claim performance in kind). The obligee shall be entitled – in accordance with the relevant regulations – to demand compensation for damages caused by the breach of contract, even if he or she has not enforced his or her claim for a default penalty. Penalty is one-sided: it relieves the obligee of the burden of proving the loss he or she suffered as far as the penalty extends, but it would not limit the obligations of the obligor. In this way, the penalty fixes only the minimum amount to be paid in the event of a breach but does not set the maximum, so it is not a proper tool for standardising damages and providing the proper allocation of risks.

Liquidated damages clauses are surely the most reasonable and optimal method of risk allocation in commercial relationships. They make the risks of the obligor as well as the recovery of the obligee predictable and help to avoid the costs of a later dispute emerging from the uncertainties relating to the necessity of proving the loss of the aggrieved party. This is why liquidated damages clauses are frequently applied in commercial transactions in Hungarian contractual practice. As atypical guarantees are enforceable in Hungarian law,[39] liquidated damages clauses are basically to be held as enforceable agreed remedies. There are, however, two great ambiguities concerning their enforceability.

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

One ambiguity is the risk that the courts may construe the liquidated damages clause as a penalty. For example, if the parties agree that in the event of a breach of contract, the party in breach shall pay to the aggrieved party a certain sum specified in the contract, the court may come to the conclusion that the parties agreed to a penalty. In the course of construing the contract, the Hungarian Supreme Court seems to be inclined to come to the conclusion that a stipulated sum to be paid as a consequence of the breach of the other contracting party is to be qualified as a penalty.[40]

The other ambiguity is that if the actual loss of the aggrieved party exceeded the sum of the agreed remedy, the actual effect of the liquidated damages clause would be a limitation of liability. Limitation of liability shall be enforceable only if it complies with the test provided in §314 of the Hungarian Civil Code, i.e., the breach was neither intentional nor the result of gross negligence or a crime, it did not involve personal injury and the party relying on the liquidated damages clause in order to avoid paying more than the agreed sum provided adequate compensation for the limitation.

Thus, although liquidated damages clauses are to be enforceable in spite of their atypical character in Hungarian law, there is a considerable risk of them being construed as penalty clauses or deemed to be exclusion clauses falling under the limits of enforceability, i.e., they cannot be enforced in cases of breach of contract with intentional conduct, gross negligence or crime, or in order to limit liability for personal injury and – in cases of patrimonial damage – if adequate compensation was not provided for the limitation. In both cases, the result is that – as a remedy for breach of contract – the aggrieved party is not prevented from claiming compensation for the loss exceeding the liquidated damages in spite of the agreement.

11 Indemnity

Atypical obligations in Hungarian court practice are accepted as enforceable promises. Undertaking an obligation to pay a certain sum to the other party if agreed circumstances occur (e.g., the failure of payment of a certain sum by another person to the obligee) is normally held to be

[40] The Hungarian Supreme Court seems to be inclined to follow this interpretation: Supreme Court Legf. Bír. Pfv. IX. 21.385/2008. – BH 2010. No. 16 and Supreme Court, Legf. Bír. Gfv. X. 33. 092/1994. sz. – BH 1995. No. 722.

enforceable by Hungarian courts.[41] Such promises are construed as atypical guarantees. Court practice accepts them as contractual obligations that are binding and enforceable upon the terms agreed by the parties.[42] Such guarantees are construed according to their content. The use of terminology that assumes damage actually has occurred does not necessarily prevent the guaranteed payment when no actual damage has occurred if, upon the agreed terms, the agreement of the parties shall be construed as not assuming actual loss to be enforced.

12 Representations and warranties

Allocation of information is one of the most complex problems of contract law. The decision of an uninformed party is not a free decision, which might mean that the market constituting the economic environment of the contract is imperfect. Thus, sustaining the freedom of decisions and market mechanisms would justify a requirement placing the parties in the same informed situation. Information asymmetry may be seen as a market failure which should be corrected. On the other hand, a general obligation to share all the information a party has would discourage investment in the production of information, which would have the consequence of halting innovation. All of the legal systems, to a certain extent, provide – impliedly or explicitly – for establishing a duty to speak or a duty to inform before contracting, while setting the boundaries of this obligation.

In the Hungarian Civil Code, there are additional provisions establishing a duty to cooperate and a duty to inform the other party of circumstances relevant to the contract. At the centre of this is the general requirement of good faith and fair dealing (§4), which is also to be applied in this context and which may be a general source of an obligation of a duty to disclose.

§205(4) of the Hungarian Civil Code explicitly requires that parties shall inform each other of all the relevant circumstances of the contract. If there is an infringement of this duty, this may be a ground for avoidance of the contract because of mistake or misrepresentation and/or it may be a basis for damages in tort or a remedy for breach of contract as an alternative to avoidance for mistake or misrepresentation. According to §210(1) of the Civil Code, if a party concludes the contract

[41] Supreme Court, Legf. Bír. Pf. IV. 20 561/1991. sz. – BH 1992. No. 239.
[42] Supreme Court, Legf. Bír. Gfv. I. 33.312/1997. sz. – BH 1998. No. 440.

by erring on a substantial circumstance of the contract, and the other party caused or should have recognised the mistake, the contract may be avoided by the aggrieved party (mistake and/or misrepresentation). If the parties shared the same mistake, either of them shall be entitled to avoid the contract. If a party convinces the other to contract through deceit, the contract may be avoided by the aggrieved party. The same rule shall be applied if the deceit was carried out by a third party and the contracting party knew or should have known this to be the case (§210(4) of the Hungarian Civil Code). The avoidance of the contract does not prevent the aggrieved party from claiming damages on the basis of liability in tort (§339) or under §6. In cases where the party (typically the seller) provided information regarding the product to be the subject of the contract, the information may be implied as a contractual term and part of the contract according to §277(1)(b) of the Hungarian Civil Code.[43] This construction establishes the contractual liability of the party if the product fails to meet the alleged quality. In these cases, avoidance of the contract (on the ground of mistake, misrepresentation or deceit) and remedy for breach of contract are alternative claims for the plaintiff. Avoidance of the contract excludes the liability for breach of contract – however, avoidance of the contract does not exclude the establishment of a claim of liability in tort or based on §6 of the Hungarian Civil Code.

Incompliance with the required standard of good faith and fair dealing, the duty to cooperate or disclosure may also result in liability in tort,[44] independently of other consequences relating to the enforceability

[43] Even without this explicit provision, the construction of the contract may lead (and might have led) to the same result in practice.

[44] Liability consequences of failure to fulfil the obligation of the duty to speak may be presented by the following decision of the Hungarian Supreme Court. In this case, the plaintiff bought a building site and built a house directly next to the public railway line between Budapest and Hegyeshalom, because he relied on the railway reconstruction plans, according to which the railway would have been relocated about one kilometre further away. After the building of the house, these reconstruction plans were altered and the programme of relocating the railway was also cancelled. It also turned out that the plan was only in a very early phase and there was only a concept without a final decision. The plaintiff claimed for damages on the ground that he had relied on the information about the railway relocation plans and had bought plots of land and built houses near the railway because he assumed that the railway would be moved. The defendants were the Hungarian State Railway Company and the local government, who sold the land as the seller. The Supreme Court decided in favour of the plaintiff and ordered the local municipality to pay damages at about 60:40 ratio, where the defendant had to pay the larger amount. The claim against the State Railway Company was rejected. The court declared that the buyer had also contributed to his own loss because, before contracting,

of the contract. Liability in tort is one of the basic consequences of incompliance with these duties according to §339 of the Hungarian Civil Code. Eörsi, whose theory deeply influenced modern Hungarian tort law theory and regulation, emphasises that in Hungarian tort law, there is no gap that should be filled with the *culpa in contrahendo* doctrine. He explicitly refers to §339 of the Civil Code (the basic norm of liability), the principle of good faith and fair dealing and the duty to cooperate in §4(2) to establish liability for cases qualified as *culpa in contrahendo* in German court practice and literature.[45]

To sum up, representations and warranties describing facts, circumstances, expectations, etc., which are made relevant by the parties for their contracting may basically result in the following consequences, depending on the construction of the representations and warranties and the agreement of the parties:

1) Facts, circumstances, expectations, etc., described in the representations and warranties are made part of the contract and part of

he should have investigated the stability and finality of these reconstruction plans more thoroughly. His contribution should reduce the damages to be paid by the defendants by 20 per cent. According to the decision, the defendant failed to provide the proper information to the buyer regarding the railway reconstruction. The basis of their obligation to do so was the requirement of good faith and fair dealing. The damage was the depreciation in value of land due to the abandoning of the reconstruction plans. The liability of the seller for false information was established here on non-contractual grounds. Until this decision, such cases concerning liability for information were relatively rare in Hungarian court practice. In the present case, the court shifted the risk of the realising of the reconstruction plans to the defendant. Another line of argument, according to which it should have been the risk of the buyer, also sounds correct, since the court did not investigate whether the contractual will of the buyer was and to what extent it was influenced by these plans; thus, one could argue that this was a kind of speculation relying on the planned reconstruction to buy a plot of land cheaply and later on, after the railway relocation, to have a more valuable plot. It also should have been taken into account whether or not the planned reconstruction was a factor affecting the price of the plot of land when the buyer bought it. These factors – especially the risk allocation element – seem to fall outside the arguments of the court. The damage was the fall in the value of the land, which occurred at the moment when it turned out that the reconstruction would not be realised. The plaintiff was not the only one affected; there were other adversely affected owners who could have sued in separate cases. Supreme Court, Legf. Bír. Pfv. IX. 20.130/2001. sz. – BH 2003. No. 195.

[45] According to Eörsi, in German legal theory and practice, it was necessary to develop such a doctrine because of the gap in the rules of liability for tort and for breach of contract left in the BGB. Because of the general clause of liability in §339 of the Hungarian Civil Code, such a gap does not exist in Hungarian private law. Since these cases are covered by §339 of the Civil Code, it was not necessary to develop such a doctrine. G. Eörsi, *Elhatárolási problémák az anyagi felelősség körében* (Közgazdasági é s Jogi Könyvkiadó, 1962), p. 181.

the party's contractual duty. Incompliance with them is a breach of contract and the remedies are the agreed or statutory remedies for breach of contract, including contractual liability.

2) Facts, circumstances, expectations, etc., described in the representations and warranties are the agreed basis of the contract. If they prove to be false or frustrated, this may result in the unenforceability of the contract either by making the contract voidable on the basis of mistake or deceit, or by resulting in frustration of purpose, which terminates the contract and turns into the liability of the party responsible for the deceit or the frustration.[46]
3) If the facts, circumstances, expectations, etc., described in the representations and warranties do not become part of the contract and they prove to be false or frustrated, this may result in liability in tort of the party declaring, confirming or undertaking them.

Whether representations and warranties shall be held as a closed list of relevant matters concerning the basis and the content of the contract or the expectations of the parties protected by the contract depends on the construction of the representations and warranties clauses of the contract. If the list is not construed as a closed one according to the agreement of the parties, the matters left out fall under the general duty of disclosure. If the list is construed as a closed one, matters left out shall be deemed as explicitly declared irrelevant by the parties, which may result in the parties being considered to have waived the legal protection otherwise provided by the law. As, however, waiver of rights is to be narrowly construed (§207(4) of the Hungarian Civil Code), the court would presumably hold the list to be a closed one, resulting in a waiver of the legal protection otherwise provided by the law if the parties explicitly agreed on this. There is no standardised interpretation concerning the exhaustive nature of the list or whether it is to be held as integrated by the information duties under contract law regulation.

[46] According to §312 of the Hungarian Civil Code, if performance has become impossible for a reason that cannot be attributed to either of the parties, the contract shall be held as terminated. If performance has become impossible for a reason for which the obligor is liable, the obligee may claim damages for breach of contract. If performance has become impossible for a reason for which the obligee is liable, the obligor shall be relieved of his or her obligation and shall be entitled to demand damages therefrom. If performance of any of the alternative services becomes impossible, the contract shall be limited to the other services.

13 Hardship

The change of circumstances that make the performance excessively onerous for the party may have an impact on the enforceability of the contract in two basic ways.

First, supervening or external events that make the performance excessively onerous for a party may result in physical or economic impossibility of the contract. *Ex post* impossibility terminates the contract if performance has become impossible for a reason that neither of the parties is responsible for. If performance has become impossible for a reason for which the obligor is liable, the obligee may claim damages for breach of contract. If performance has become impossible for a reason for which the obligee is liable, the obligor shall be relieved of his or her obligation and shall be entitled to claim damages therefrom.

Secondly, on the basis of the claim of the party, the court may amend a contract regulating a long-term relationship if, as a result of changed circumstances of contracting, the performance of the contract became excessively onerous for one of the parties (§241 of the Hungarian Civil Code). A similar rule is to be applied if the external circumstance making the contract excessively onerous for the party is an *ex post* statutory amendment (§226(2)). A party is prevented from claiming a judicial amendment of the contract on the ground of realisation of a risk allocated to him or her by the contract, or if the change of circumstances could have been foreseen at the time of the conclusion of the contract.[47]

Whether a detailed definition of such changed circumstances in the contract prevents a court from considering the other circumstances provided for by contract law depends on the result of construction of the parties' agreement on hardship. There is no generally accepted standardised approach in Hungarian court practice and theory concerning this. The parties are to be held as basically free in their agreement to determine circumstances that may be relevant from this point of view, but as the result would restrict the parties' opportunities concerning judicial amendment, such a construction is to be held as a waiver to be construed narrowly. This may lead the court to the conclusion that the list provided by the parties in the contract describing the circumstances that may be relevant in the context of hardship is to be construed as the sole applicable regulation only if the parties explicitly agreed to this.

[47] Supreme Court, Legf. Bír. Pfv. II. 21.281/2003. sz. – BH 2005. No. 347.

14 *Force majeure*

Force majeure, as a ground for relief of the contractual obligation or as a prerequisite of exoneration, is not used in contract law regulation. In Hungarian private law, the policy underlying tort law regulation of the Civil Code 1959 was to provide a unified system of liability. This idea included the unitary regulation of liability for tort and for breach of contract. According to §318(1) of the Hungarian Civil Code, the rules of delictual (tort) liability are to apply for liability for breach of contract as well, except as otherwise provided by the law. This solution reinforces the idea of a common moral basis of liability – irrespective of whether the obligation that is breached arises out of a contract or is imposed by operation of law – and makes the system a simple one, avoiding borderline problems and the constant necessity of classifications. The distinction made by the Hungarian Civil Code (§318(1)) is that liability for breach of contract cannot be reduced on equitable grounds (which is allowed in the event of delictual liability according to §339(2)) and there are differences in the preconditions of the validity of exclusion clauses and the liability for third persons as well. The earlier court practice in Hungary was somewhat confusing, since decisions were often based on the basic rule of liability (§339) instead of referring to the special rule for contractual liabilities (§318) in cases of remedies for breach of contract. At the beginning of the 1970s, a tendency towards preferring the contractual basis could be detected,[48] and this tendency has developed into a clear standpoint today. If there is a concurrence of contractual and non-contractual (tort) liability, the courts refer to the special rule of liability for breach of contract provided in §318 and decide the case on the basis of contractual liability.[49] One obvious and significant difference has, however, been clearly developed in court practice and this is the different measures for exculpation: in contractual cases, the courts apply stricter tests in assessing whether the party was at fault and allow exculpation only if the party can prove that the harm in the given circumstances was unavoidable. Thus, the level of the required standard of conduct in contractual liability is higher than in tort cases, as the party shall be liable for breach of contract insofar as the breach (i.e., the cause of the

[48] A. Harmathy, *Felelősség a közreműködőért* (Közgazdasági és Jogi Könyvkiadó, 1974), p. 202.

[49] J. Gyevi-Tóth, 'A szerződéses és a deliktuális felelősség egymáshoz való viszonya', in A. Harmathy (ed.), *Jogi Tanulmányok* (ELTE, 1997), p. 178.

breach) was avoidable.[50] This approach provides a wider relief of liability as the unavoidable circumstances will not necessarily fall outside the scope of the party's activity in order to lead to exoneration, but presupposes that it fell beyond the control of the party, which seems to be a wider circle than in cases of *force majeure*.

However, the parties shall be free in defining and designing their requirements as they do not limit their liability (which falls under the test of §314 of the Hungarian Civil Code). *Force majeure* clauses in this context may be construed in two ways, depending on the content of the agreement of the parties. Either they specify the cases where the party shall not be liable for breach of contract and provide a closed exhaustive list of the circumstances relieving the party of the obligation he or she undertook in the contract, or they simply mention cases where the party certainly shall not be liable even if there may also be cases of unavoidable events providing relief to the party. Both of the possible constructions are enforceable under Hungarian contract law. The result of the first construction (an exhaustive list of relief of obligations) is that the contract makes the liability of the party stricter than would be the case under the general statutory regime of liability for breach of contract. In this way, *force majeure* clauses do not change the statutory system of liability, but instead specify it. Neither under the statutory regime nor under the application of *force majeure* clauses is it enough for the party to prove that he or she was diligent and acted in good faith in order to be relieved of liability for breach of contract; rather, he or she has to prove that under the given circumstances, it was not possible to avoid a breach.

[50] I. Kemenes, 'A gazdasági szerződések követelményei és az új Polgári Törvénykönyv', *Polgári Jogi Kodifikáció*, 1 (2001), 9.

16

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

IVAN S. ZYKIN

1 Introductory remarks

In line with the general topic of this book, the purpose of the present chapter is to ascertain to what extent different terms of a commercial contract based upon the concepts of Anglo-American law are compatible with Russian law, if the latter is applicable. This chapter focuses mainly on substantive law issues, leaving aside the issues of Russian private international law (PIL).[1]

Naturally, Russian law is influenced to a certain extent by the laws of other countries, Anglo-American law not being an exception. Contracts of finance lease, agency, franchise and entrusted management of property governed by the Civil Code of the Russian Federation (RCC) may be cited as examples. However, Russian legal rules dealing with such contracts are adapted to the continental law system, to which Russia belongs.

Another channel for such an influence is the international conventions in which Russia participates. The most notable example here is the 1980 United Nations (Vienna) Convention on Contracts for the International Sale of Goods ('CISG'). The impact of Anglo-American legal concepts can be traced in some provisions of the CISG. When the currently-in-force RCC was elaborated in the 1990s, the CISG was taken into account not only with regard to sales contracts, but also when drafting the general provisions of contracts.[2]

[1] The main body of PIL rules in Russia is found in Division VI (Articles 1186–1224) of the Civil Code of the Russian Federation (the RCC).

[2] See A. L. Makovskiy, 'The Influence of the 1980 Vienna Convention on the Development of Russian Law', in A.S. Komarov (ed.), *The Vienna Convention on Contracts for the International Sale of Goods. Practice of Application in Russia and Abroad* (Wolters Kluwer, 2007), pp. 123–131 (in Russian); M. I. Braginskiy, 'The 1980 Vienna Convention and the RCC', in M. G. Rozenberg (ed.), *The 1980 Vienna UN Convention*

Nevertheless, one has to admit that the degree of influence of Anglo-American legal concepts upon Russian law is rather limited and should not be overestimated.

The CISG applies to contracts for sale of goods between the parties whose places of business are in different states: (a) when the states are participants of it; or (b) when the rules of PIL lead to the application of the law of a state participating in the CISG (Article 1(1)). If Russian law is the applicable law by virtue of Article 1(1)(b), it entails the application of the CISG, which actually replaces the relevant provisions of the RCC, which could then be applied only subsidiarily. This holds true not only where the conflict of law rules point to the application of Russian law, but also where the parties agree to apply Russian law without expressly excluding the application of the CISG. Therefore, it should be borne in mind that Article 1(1)(b) of the CISG considerably widens the sphere of its application and respectively narrows the sphere of application of the relevant national law that is otherwise applicable, namely Russian law.[3]

The RCC has special provisions on the interpretation of a contract. According to Article 431, a court should first be guided by a literal meaning of a contract term, taking into account, if necessary, other terms of the contract and the sense of the whole contract. If the meaning of the contract term could not be thus established, then the real common will of the parties must be ascertained, taking into account the purpose of the contract and all associated circumstances.[4] However, Article 431 does not say what legal meaning should be attributed to the contract

on Contracts for the International Sale of Goods. The Ten Years of Application by Russia (Statut Publishing House, 2002), pp. 14–17 (in Russian).

[3] See M. G. Rozenberg, 'Application of the 1980 Vienna Convention in the Practice of the ICAC at the RF CCI', in A. S. Komarov (ed.), *International Commercial Arbitration. Modern Problems and Solutions* (Statut Publishing House, 2007), pp. 336–340 and the literature cited therein (in Russian). See also P. Schlechtriem and I. Schwenzer (eds.), *Commentary on the UN Convention on the International Sale of Goods (CISG)*, 2nd edn (Oxford University Press, 2005), pp. 15–40, 90–92.

[4] Article 431 of the RCC states:

> In the interpretation of the terms of a contract a court shall take into account the literal meaning of the words and expressions contained in it. The literal meaning of a term of a contract, in case the term is not clear, shall be established by comparison with the other terms and the sense of the contract as a whole.
>
> If the rules contained in the first part of the present Article do not allow the determination of the content of the contract, the real common will of the parties must be ascertained, taking into account the purpose of the contract. In such a case all surrounding circumstances shall be taken into account, including negotiations and correspondence preceding the

term in situations where such a term is based upon the concepts of a foreign law. The problem here is to determine how the given term should be classified or qualified on the basis of the legal concepts or categories of the applicable law.

A similar issue arises in the sphere of PIL, where it is called the problem of characterisation and is known to be a fundamental problem. The core of the problem is that the terms used in a conflict-of-law rule may be understood quite differently from country to country, and a proper interpretation of the term becomes essential for the determination of the applicable law. The problem of characterisation is specifically addressed in some national laws[5] and there exists abundant literature on the subject.[6]

Once the applicable law is determined, the meaning and legal effect of a particular contractual term is to be established on the basis of the legal concepts or categories of the applicable law.[7] In contrast with the issue of characterisation in PIL, the problem of proper determination of the effect of contractual terms inspired by foreign law on the basis of Russian substantive law is not adequately studied in Russian doctrine. The existing literature on comparative law, specifically in Russia, does not help much. This literature focuses on a comparison between the legal concepts and rules of different countries, whereas in a given case the task is to determine how certain contractual terms are compatible with the national law in question. The fact that those contractual terms also find their basis in law (though a foreign one) does not overshadow the

> contract, the practice established in the mutual relations of the parties, the customs of commerce, and the subsequent conduct of the parties.

See Peter B. Maggs and Alexei N. Zhiltsov (eds. and translators into English), *The Civil Code of the Russian Federation*, parallel Russian and English texts (Norma Publishing House, 2003). Further, the translation of the RCC made by these authors is used.

[5] E.g., see Article 1187 of the RCC, 'Characterization of Legal Concepts in the Determination of the Applicable Law'. See, inter alia, L. Collins LJ, C. G. J. Morse, D. McClean, A. Briggs, J. Harry and C. McLachlan (eds.), *Dicey, Morris & Collins on the Conflict of Laws*, 14th edn, 2 vols. (Sweet & Maxwell, 2006), vol. I, pp. 37–52 and the literature cited therein.

[6] See, inter alia, Collins *et al.*, *Dicey, Morris & Collins*, vol. I, pp. 37–52 and the literature cited therein.

[7] This approach is widely shared by Russian scholars. See M. M. Boguslavskiy, *Private International Law*, 6th edn (Norma Publishing House, 2009), pp. 113–115 (in Russian); V. P. Zvekov, *Conflict of Laws in Private International Law* (Wolters Kluwer, 2007), pp. 180–190 (in Russian); and V. A. Kanashevskiy, *Foreign Economic Transactions: Substantive and Conflict of Laws Regulation* (Wolters Kluwer, 2008), pp. 165–166 (in Russian).

situation that here the task is to juxtapose the contractual terms (a category quite different from legislation) and the law.

The mere fact that certain contractual terms are based on foreign law concepts unknown to Russian law obviously does not mean that their legal force is not recognised *per se*. According to Article 6(1) of the RCC, if civil law relations 'are not directly regulated by legislation or agreement of the parties and there is no custom of commerce applicable to them, then civil legislation regulating similar relations (analogy of statute) shall be applied to such relations, if it does not contradict their nature'. Article 6(2) of the RCC provides further guidance. If it is impossible to resort to the analogy of statute, 'the rights and obligations of the parties shall be determined proceeding from the general principles and sense of civil legislation (analogy of law) and the requirements of good faith, reasonableness, and justice'. It should be added that the application of the analogy of statute or the analogy of law could be quite a difficult task from a practical point of view, with a result which is hard to foresee.

Under Article 1(2) of the RCC, the parties 'are free in the establishment of their rights and duties on the basis of contract and in determining any conditions of contract *not contradictory to legislation*' (emphasis added). According to Article 422(1), 'a contract must comply with rules obligatory for the parties established by a statute and other legal acts (imperative norms)'. Subject to those mandatory rules, 'the terms of the contract shall be determined at the discretion of the parties' (Article 421(4)).

Therefore, as a minimum test, contractual terms should not contradict the mandatory rules of Russian legislation. Russian law, judicial practice and doctrine do not recognise such a phenomenon as a self-regulatory contract being totally detached from the mandatory provisions of the applicable law.

Russian law imposes certain general restrictions aimed at a proper exercise of civil law rights. Those restrictions are laid down in Article 10 of the RCC.[8] It prohibits abuse of a legal right in any form. The concept of

[8] Article 10 of the RCC, entitled 'Limits of Exercise of Civil-Law Rights', runs as follows:

1. Actions of citizens and legal persons taken exclusively with the intention to cause harm to another person are not allowed, nor is abuse of a legal right allowed in other forms.
   Use of civil-law rights for the purpose of restricting competition is not allowed, nor is abuse of one's dominant position in the market.
2. In case of failure to observe the requirements provided by Paragraph 1 of the present Article, the court, commercial court, or arbitration tribunal may refuse the person protection of the rights belonging to him.

abuse of rights is rarely applied by Russian courts. The current legislation does not establish a formal general requirement to act in good faith, though it is set forth in certain specific instances.[9] In practice, a rather broad notion of the prohibition of abuse of a legal right somehow partly compensates for the relatively limited ambit of the good faith requirement.[10] The proposed reform of the Russian civil legislation envisages a considerable enlargement of the ambit of the good faith requirement as a general overriding principle applicable both when a contract is being negotiated and after its conclusion.[11]

The answer to the issues considered herein might depend upon a number of factors. The specific circumstances of a particular case are one of the most important factors of that sort. The degree of acquaintance of a particular law-applying body with the relevant foreign legal concepts or categories might also come into play.[12]

The foregoing general starting considerations are better understood when applied to particular contractual terms, which are dealt with below.

2 Some particular contract clauses[13]

2.1 Entire agreement

Similar clauses are frequently encountered in contracts entered into by Russian parties and normally do not create serious problems. The issue

3. In cases when a statute places protection of civil-law rights in dependence upon whether these rights were exercised reasonably and in good faith, the reasonableness of actions and the good faith of the participants in civil legal relations shall be presumed.

[9] E.g., according to Article 53(3) of the RCC, 'a person who, by virtue of a statute or the founding documents of a legal person, acts in its name must act in the interests of the legal person represented by him in good faith and reasonably'.

[10] See Informative Letter of the Presidium of the RF Supreme Arbitrazh Court, dated 25 November 2008, No. 127, entitled 'A Review of the Practice of Application by Arbitrazh Courts of Article 10 of the Civil Code of the Russian Federation'. Arbitrazh courts are specialised state commercial courts which, in spite of a misleading similarity of the name with commercial arbitration bodies, should not be confused with the latter. Informative letters of the Supreme Arbitrazh Court are regarded as a summary of good judicial practice and are normally followed by lower commercial courts.

[11] See *The Concept of Development of the Civil Legislation of the Russian Federation* (Statut Publishing House, 2009), pp. 30–31. The concept was adopted by the RF President on 13 October 2009 and is being implemented now.

[12] This, in turn, is linked with the frequency of dealing with international commercial transactions by such a body. The most experienced in the field in Russia is the International Commercial Arbitration Court ('ICAC') at the RF Chamber of Commerce and Industry ('CCI') with nearly eighty years of practice and a considerable case load.

[13] For the text of the clauses analysed here, see the introduction to Part 3 of this book.

that does arise is whether prior negotiations, representations, undertakings and agreements could still be taken into account when interpreting the contract irrespective of the express provision that they are superseded by the contract.

Article 431 of the RCC[14] does not exclude this possibility, namely when the literal meaning of contractual terms is not clear and there is a need to ascertain the real common will of the parties. According to the language of Article 431(2), in such a case, all surrounding circumstances should be taken into account, including, inter alia, negotiations and correspondence preceding the contract and the practice established in the mutual relations of the parties.

The wording of the contractual clause limits the possibility of relying upon prior negotiations, representations, undertakings and agreements. Yet the possibility to take them into account, in my view, is not completely ruled out. This might be true where they do not contradict the terms of the contract and help to establish the real common will of the parties, which would otherwise remain obscure. In other words, prior negotiations, representations, undertakings and agreements might be of relevance to the extent that they make it possible to ascertain the meaning of the terms of the existing contract. There may be no other way for a court to achieve a satisfactory result. However, much depends upon the circumstances of a particular case.

2.2 No waiver

The Anglo-American legal concept of a waiver is not recognised by Russian civil law.[15] From the point of view of Russian law, one could regard as superfluous the contractual provision that a failure by a party to exercise a right or remedy the party has under the contract does not constitute a waiver thereof. According to the general rule of Article 9(2) of the RCC, even a waiver by persons to exercise rights belonging to them should not entail the termination of those rights, unless otherwise stipulated by statute.

[14] Cited in note 4 above.

[15] This concept is embodied in Article 4 of the 1993 Russian Law on International Commercial Arbitration, which is completely identical to Article 4 of the UNCITRAL Model Law on International Commercial Arbitration. However, it covers a distinct and limited area of international commercial arbitration. It may be noted in general that the 1993 Russian Law closely follows the UNCITRAL model.

Thus, for example, even if a party exercises its right with a considerable delay, this usually does not lead to relinquishment of the right. The claim may be time-barred, but that is another matter.

2.3 No oral amendments

The clause stipulating that no amendment of the contract will take effect unless it is done in writing fully corresponds to Russian law. Article 162 (3) of the RCC contains a mandatory requirement that a foreign economic transaction should be made in writing. The violation of this requirement renders the transaction invalid, and such a transaction is void. To ensure the application of this rule, Article 1209(2) of the RCC provides that Russian law shall govern the form of a foreign economic transaction in which at least one of the parties is Russian.[16]

There is no legal definition of a foreign economic transaction. For practical purposes, it would be enough to say that international commercial contracts between Russian and foreign parties fall under this category.

The written-form requirement is equally applicable to any amendments and supplements to such contracts. This requirement is strictly followed by Russian state courts and arbitral tribunals sitting in Russia.[17]

2.4 Conditions

The concept of fundamental breach is embodied in Article 450(2) of the RCC. Fundamental breach of a contract by a party entitles the other party to rescind the contract. Under Russian law, the same remedy is also available to the aggrieved party in other cases, as provided by statute or contract.

The wording of the contractual clause may be different. It may be stipulated that certain obligations are regarded by the parties as fundamental and any breach thereof should amount to a fundamental breach of the contract. The contract may simply state that in the event of a breach of certain obligations by a party, the other party is entitled to

[16] Some eminent Russian scholars regard Articles 162(3) and 1209(2) of the RCC as overriding mandatory provisions with extra-territorial effect (see Boguslavskiy, *Private International Law*, pp. 131 and 298; Zvekov, *Conflict of Laws*, pp. 294–295; and others).

[17] See M .G. Rozenberg, *International Sale of Goods. Commentary to Legal Regulation and Practice of Dispute Resolution*, 3rd edn (Statut Publishing House, 2006), pp. 64–77 (in Russian).

terminate the contract. The effect would be the same as where a commercial contract provides for the possibility of rescinding the contract unilaterally, no matter how substantial the breach is. The freedom of the parties' will is respected, unless it otherwise follows from statute or the nature of the obligation (Article 310 of the RCC).

If, under the circumstances, a party attempts to rescind the contract despite such a remedy being manifestly disproportional to the consequences of the breach, the opposite party might rely in its defence upon the prohibition of abuse of a legal right set forth in Article 10 of the RCC (see above).

2.5 Liquidated damages

In Russian practice, contractual clauses providing that, upon a failure of performance by one party, that party is obliged to pay an agreed sum to the other party are very common. International commercial contracts concluded by Russian entities with foreign companies do not constitute an exception in this regard.[18] As is well known, the legal concept of agreed and liquidated damages in English law and American law is not identical to the legal concept of penalty in continental laws, including Russian law.

Irrespective of the existing differences, the concept of agreed and liquidated damages is more similar to the concept of penalty in Russian law than to any other concept of that law. Consequently, the relevant contractual clause would normally be interpreted as a penalty clause under Russian law. A penalty is defined in Article 330(1) of the RCC as 'a monetary sum determined by a statute or a contract that the debtor must pay to the creditor in case of non-performance or improper performance of an obligation, in particular in case of a delay in performance'. Like the position of English law and American law, it is further added that when claiming payment of a penalty, the creditor does not have a duty to prove that he or she sustained losses.

Another alternative is to qualify such a clause as a provision specifying the amount of *damages* to be paid in case of a breach of an obligation. Russian law does not prohibit the parties from reaching such an agreement. As stated in Article 15(1) of the RCC, an aggrieved person is

[18] Very often, such contracts made in two languages use different legal terms to designate the said sum: agreed and liquidated damages in English and penalty ('neustoika') in Russian, thus creating some additional uncertainty.