

## **Termination of Contracts: Theory and Practice in Hungary**

Today we already examined the various phases of the terms of agency, distribution and franchise contracts. Finally we got as far as the "end" of the life of contracts, that is, the termination of contracts.

In my lecture, I primarily concentrate on the independent commercial agency contract, in the light of Hungarian regulations in force, but where necessary, I also mention franchise and distribution contracts.

But prior to that let me tell some words **about the Hungarian legal rules in force**, affecting the business contracts examined, and about the development thereof.

Act CXI of 2000 on Independent Commercial Agency Contracts was prompted by European impacts. The Act was promulgated prior to the access of Hungary to the European Union, relying on Directive No. 86, the so-called commercial representatives directive. We use the Hungarian Civil Code as a background rule, the Independent Commercial Agency Act in the field of agency law, and a few separate legal rules in certain special fields of mediation activities, like real estate transactions, financial advice, etc.

No legal regulation is in force in respect of franchise. The contents of franchise contracts are primarily defined in the European Code of Ethics also applied by the Hungary Franchise Federation.

Distribution contracts are not regulated as independent, named contracts in Hungarian law. The elements of the sales contracts, as well as of the contracts of agency, as can be found in distribution contracts.

When speaking about the present, we have to mention the role of judicial practice, relating to the interpretation of legal rules. Well, this cannot be called a "main role" in Hungary nowadays! What follows from that? Perhaps, Hungarian attorneys-at-law prepare good contracts. However, court practice could point out the serious violations of obligations that result in the immediate termination of a commercial agency contract.

Furthermore: What concerns franchise, we have to mention, by all means, that as a result of the application of the excellent Code of Ethics relating to franchise, disputes do not even come before courts.

The practice of supreme courts is also missing in the field of distribution contracts, especially in respect of the application of the rules of agency law relating to settlement in the case of the termination of such contracts. In the absence of court practice, we include a provision in the contract whereby, for instance, *in the case of the termination of a sales/brand dealer contract*

*the customers' database remains the property of the dealer, or whether the manufacturer will be obliged to pay separate remuneration to the dealer for the delivery of such details.<sup>1</sup>*

### **A few words about future:**

A new civil law code is under preparation in Hungary. It will be a standard private law code, and the commercial agency legal material will be also included in the new code. On that occasion, certain additions adjusted to the directive will also be made. For instance, the right applicable to *the drawing up of documents is not included in the present Hungarian legal regulation; the validity of the contract is only made subject to a written form<sup>2</sup>. The Directive makes the provision of the right relating to the drawing up of documents mandatory, and allows the rule of written form over and above the right relating to the drawing up of documents.<sup>3</sup> Considering all this, inauguration of the right relating to the drawing up of documents cannot be ignored.<sup>4</sup>*

Franchise will continue to qualify as a non-typical contract, and the new Civil Code Draft also refuses regulation.

Coming to the main subject of the lecture, let us see **the rules of termination in Hungarian law** in the case of the contracts examined.

In the first part of my lecture, I will examine the methods and consequences of termination, in the second part, the contractual stipulations surviving the termination of the contract, and in the third part I will analyze the consequences of the changes in contractual circumstances (hardship) and the reasons why the applicable regulation cannot be found in Hungarian law.

#### 1. **Methods and consequences of termination in general<sup>5</sup>**

The contracts examined regulate long-term legal relationship, and therefore performance of a contract does not result in automatic termination. Termination may occur on the basis of an agreement on termination, the unilateral law formation and upon the happening of certain events.

1.1 **A mutual agreement** on termination may be included in the contract itself, if a definite period of time is stipulated upon the conclusion of the contract, but the contract may also be terminated by mutual agreement on a later date.

<sup>1</sup> Pajor-Bytomski Magdalena: A kereskedelmi ügynöki szerződés, 59. o. Complex Kiadó 2003

<sup>2</sup> Pajor-Bytomski Magdalena in: Vékás Lajso (szerk): Szakértői javaslat az új Ptk tervezetéhez, Budapest, Complex Kiadó 2008, 969. o.

<sup>3</sup> Pajor-Bytomski Magdalena: A kereskedelmi ügynöki szerződés, 65. o. Complex Kiadó 2003

<sup>4</sup> Vékás/Pajor-Bytomski: Szakértői javaslat az új Polgári Törvénykönyv tervezetéhez, Budapest, Complex Kiadó 2008, 969. o.

<sup>5</sup> Lsd. Bővebben: Pajor-Bytomski Magdalena: A kereskedelmi ügynöki szerződés, 147. o., Complex Kiadó 2003

1.2 The termination of the contract is an **act establishing unilateral legal relationship**; it has two methods: termination by ordinary notice and extraordinary termination. Both methods are allowed to both parties.

1.2.1 Contracts concluded for an indefinite period of time may only be **terminated by ordinary notice**,<sup>6</sup> with a certain period of notice, in writing.

Such termination is valid without reasoning. In the case of termination by ordinary notice, the agent shall lose his right to settlement, with the exception of the case if he is able to refer to 3 definitively stated reasons by which he can justify why the carrying out of the activity cannot be expected of him. These reasons are as follows: physical disability, sickness, principal's conduct. In the case of a successful reference to such cases, the right to settlement remains in force.

Termination by ordinary notice in the case of franchise is conceptually excluded owing to the establishment of legal relationship for a definite term.

1.2.2 The other case of termination is **extraordinary termination**. Extraordinary termination is of immediate effect. Legal relationships of both definite and indefinite periods of time can be terminated this way.<sup>7</sup> It is also only valid in writing, and shall be justified in detail. It is an important rule, that extraordinary termination may only take place in the case of a serious and provable, statutory or contractual breach of contract by the other party. As I have already mentioned it, *during the relatively short period of time, the Hungarian court practice was not able to create groups of cases relating to the serious breach of contracts.*<sup>8</sup> Consequently, the concept of serious breach of obligation is waiting for interpretation, and therefore, we have to prepare very "creative" contracts in which we list the possible serious breaches of obligations. Such a serious breach of obligation is for instance, *if the principal violates his obligation of preparation and delivery of accounts several times, if he keeps the amount of commission secret, if he pays commission only after request on several occasions, if he refuses the transactions brought by agents frequently and for non-followable reasons, or if he persuades the customers of the agent to order directly from him with the exclusion of the agent.*

*It can be considered a serious breach of obligation by the agent, if the agent represents the competitor principal, if he handles the money collected negligently.*<sup>9</sup>

In the case of franchise contracts, the cases that shall qualify as breach of contract and may give reason for the termination of the contract with immediate effect shall be

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<sup>6</sup> Pajor-Bytomski Magdalena: A kereskedelmi ügynöki szerződés, 149. o. Complex Kiadó 2003

<sup>7</sup> Lsd. Bővebben: Pajor-Bytomski Magdalena: A kereskedelmi ügynöki szerződés, 153. o. Complex Kiadó 2003

<sup>8</sup> Lsd. Bővebben: Pajor-Bytomski Magdalena: A kereskedelmi ügynöki szerződés, 154. o. Complex Kiadó 2003

<sup>9</sup> Pajor-Bytomski Magdalena: A kereskedelmi ügynöki szerződés, 155-156. o. Complex Kiadó 2003

named particularly carefully, taking account of the long-term legal relationship. Otherwise, only one single judgement was passed until now by the Supreme Court in the year 2000 with regard to the termination of franchise contracts, showing an example for the termination of the contract with mutual agreement and the justification of termination with immediate effect. The judgement is particularly interesting as it stated in theory that courts may rely in the future on the contract-qualifying activity of the Hungarian Franchise Federation, and may accept the findings thereof, which refer to the lawviolating and incompatibility of qualified contracts with Hungarian law or the franchise principles.

Let me mention as a **point of interest** that although the right to withdrawal is also a right forming unilateral legal relationship, and therefore this would also result in the termination of contracts, in principle, but *the application thereof is conceptually excluded in the case of an agency contract and service, as received and provided services cannot be returned, and the original condition cannot be restored.*<sup>10</sup>

Nevertheless, we have to mention that in the case of "franchise" almost "withdrawal type" legal consequences shall be included in the contract even in respect of termination by notice, as the business interest of the franchise delivering party requires that contract be terminated "as if it did not exist at all". The immediate termination of trademark use is a good example, trademarks shall be removed from the objects in shops, posters, neon lights and advertisements bearing the trademark shall be immediately removed, all this indicates that the almost the original condition shall be restored.

It is a further serious problem in the case of the termination of a franchise contract that if the franchise receiving party does not want remove voluntarily the trademark from the objects the Hungarian law does not provide defence for the delivering party and does not allow "taking the law in his own hand" and remove the trademark himself, as even the possessor without any legal title has right to the protection of possession. Although, the delivering party may apply to the court for taking an interim measure, but this is a long procedure.

Thinking of such cases, we try to protect the delivering party with various contractual stipulations, e.g. the objects bearing the trademarks shall remain his property, the receiving party shall not be entitled to the protection of possession, etc. Consequently, it can be established that it is inevitable to lay down the procedural rules following the termination of the contract.

1.3 *Finally, certain reasons in the persons of the contracting parties may also lead to the termination of the contract. These reasons arise from the general rules of civil law,*<sup>11</sup>

<sup>10</sup> Pajor-Bytomski Magdalena: A kereskedelmi ügynöki szerződés, 148. o. Complex Kiadó 2003

<sup>11</sup> Pajor-Bytomski Magdalena: A kereskedelmi ügynöki szerződés, 148. o. Complex Kiadó 2003

for instance the contract shall also be terminated without the performance of agency if either party dies, terminates without a legal successor, becomes incapable of managing his affairs, or his power of disposal is restricted.

## **2. Let us examine now the statutory possibilities or contractual stipulations that survive terminated contracts?**

- 2.1 The **right of settlement** is the first, and for an independent commercial agent, the most important statutory possibility. This is a new legal institution in the Hungarian law system, which results from the commercial representative's directive. The directive offered an alternative to the national legislator: We may choose between the right of settlement, or the right of compensation. Lost profit arising from the lawful termination of agency contracts, as damage, could not be included in the Hungarian contractual and damage law, and therefore we have chosen the system of settlement. Unfortunately, the period of time that passed since it has been introduced is too short for the appearance of settlement disputes at courts, and therefore the relevant practical experience does not exist yet. It is expected, that this issue may lead to disputes, for instance: fixing the amount of settlement on the basis of estimation or proof of the existence and considerable rate of principal's benefits.
- 2.2 An other agreement surviving the contract is the **competition restriction agreement**, which is called competition exclusion agreement, capable of misinterpretation, in the current Hungarian law. Misinterpretation is due to the fact that this name doesn't help for making difference between the prohibition of competition during the existence of the legal relationship of agency and the prohibition of competition following the expiry of the contract. In the new civil law codification, the definition will change to an agreement relating to the restriction of competition after the contract. The present rule will also be amended to an extent *that the statutory rules of the agreement on the restriction of competition are not declared as expressly cogent provisions by the Act itself. But according to the position taken by law references, the forcing nature is involved in the rule, despite the absence of the express order of the cogent nature. This position of law references will be included in the text of the new Act.*<sup>12</sup>
- 2.3 The **agreement on secrecy** is a further agreement surviving the contract, on the basis of which the agent may not use the principal's business secrets that got to know, either during the period of the contract, or after the termination thereof, and may not reveal such secrets to third parties.

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<sup>12</sup> Vékás/Pajor-Bytomski: Szakértői javaslat az új Polgári Törvénykönyv tervezetéhez, Budapest, Complex Kiadó 2008, 983. o.

In the case of a franchise contract, too, the most appropriate defence is the conclusion of a secrecy agreement. Such an agreement restricts the potential receiving party even in the course of preliminary negotiations, as he comes to the possession of important, confidential information at that time, in particular about the field of know-how planned to be taken over.

3. Finally, **in the last part of my lecture**, I would like to mention that in the course of the preparation of long-term contracts, the parties sometimes also think of what happens if market or business conditions, or their personal circumstances change. Such types of contracts always involve the risk of changes in contractual circumstances. To handle this situation, the institution of the **hardship clause** spread in the Anglo-Saxon law practice. Hardship clause enables the contracting parties to change the obligations, if performance of the contract would involve very serious consequences in respect of one of the parties. If a contract cannot be saved by amendments, it may be terminated by the parties.

Well, in Hungary, the legal rules in force do not know the hardship clause, but changes are expected in the new Civil Code Draft.

According to the Act in force at present, contracts may be amended by court order, in the long-term legal relationship, if one of the parties suffers essential injury, as a result of the changes in circumstances. The principle of *pacta sunt servanda*, is used however very strictly in court practice, and does not accept the requests of the parties to a lawsuit.

The Draft will not change this, but following the trend relating to the increase of severity in the court practice the Draft establishes further conditions for the amendment of contracts by the court *expressis verbis*. Contracts may not be amended by the court if the parties took account of the possibility of changing circumstances upon the conclusion of the contract, if change was caused by one of the parties, and if any change in the circumstances falls within the sphere of the ordinary business risks of one of the parties. The normative statement of the last reason for exclusion seemed to be particularly necessary and was missing from the practice of law. The proposal of amendment based on the system of requirements of professional business players makes it clear that everybody shall survey himself the business risks related to the conclusion of a contract, as any decrease thereof through court help will not be possible.

**Thank you for your attention.**

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