COE ソフトロー研究資料６

BH 2000. 458.

Rules applicable to the cancellation of a franchise contract [Civil Code Articles 205 (1)-(2), 218 (3), 319 (1)-(2), 321 (1)]

Prof. Dr. Gábor Palásti
University of Miskolc, Hungary

2006

Translated hereunder is a decision of the Supreme Court of Hungary on a case regarding the termination of a franchise agreement. The Supreme Court, upholding the lower court that found the franchisor to be liable for the termination, based its decision partly on the procedures before the Hungarian Franchise Association. Thus the internal procedure of a professional body, which apparently constitutes a part of "soft law," has been accepted and relied on by the court, the most central institution of "hard law."

How and to what extent the court deferred to the "soft law," in this case the judgement by the Franchise Association, is an issue to be examined. As the court mentioned in its reasoning articles 166 (1) and 206 (1) of the Code of Civil Procedure of Hungary, which provide for the principle of "free evidence," the court appears to have considered it as one of the evidences, together with others. It would be interesting to further explore how the status of such a judgement of the professional body would be varied, should the factual situation be different.

The decision of the Supreme Court was rendered in 2000 and has been effective of 01 October 2000, being published as "BH2000.458." The translation from Magyar to English was kindly supplied by Prof. Dr. Gábor Palásti at the University of Miskolc, Hungary.

BH 2000. 458.

Rules applicable to the cancellation of a franchise contract [Civil Code Articles 205 (1)-(2), 218 (3), 319 (1)-(2), 321 (1)]

On 9 May 1995 the parties to the litigation concluded a contract of franchise, within which defendant purchased a franchise package from plaintiff to prepare and operate a deep-freezer stock house system, but in reality realized only the part of off-street selling. According to the contract the area of activity was restricted to certain parts of Baranya and Somogy counties. The contract was made for five years. According to the rules of operation of the system, defendant as franchisee rented from plaintiff transport vehicles and an installed freezing chamber on the site defendant arranged for, and sold the goods of plaintiff to consumers directly from the trucks. According to Article 5 of the

contract, plaintiff had to assist and advice defendant in the planning and developing of the franchise unit. Plaintiff also had to arrange for the proper supply of goods for the designated areas and within this duty, it also had to supply goods over the contingent specified by defendant and provide defendant with advertisement material needed for sale. According to Article 6 of the contract, defendant had to obtain all products exclusively from plaintiff or from a third person named by plaintiff, it also had to offer the entire choice of products of plaintiff as a whole, while other products or products from third parties could be obtained only upon the written permission of plaintiff. Defendant agreed to pay for the taking over of the system a one-time fee of 2.500.000.-HUF + VAT. Moreover, it also had to pay 6% of the net income from sold products. Under Article 11 of the contract the parties made a provision that if the termination of the contract is attributable to plaintiff it has to pay a compensation to defendant at the rate of 5% of its annual net turnover. More than allowing a normal cancellation of the contract it was also stated, that if any of the parties seriously breaches the contract, and fails to end the breaching conduct even after the written notice by the other party, the other party may terminate the contract with prompt effect. The contract contained a list of examples of what constitutes a serious breach. It was also stated that every communication in respect of cancellation/termination is valid only in writing.

During the time of the contract plaintiff supplied different amount of products than what defendant ordered at the rate of 19,7% of all procurement of goods. It happened on several occasions that plaintiff printed inadequate prices of goods on the throwaway ads it provided. Defendant told about these problems several times the personnel acting for plaintiff. Since the same problems arose towards other franchisees of plaintiff, defendant and other franchisees of plaintiff jointly made a proposal in writing to modify the contract on 2 October 1995. Plaintiff did not agree to the modification proposal. Following this, plaintiff started individual negotiations with its franchisees, including defendant, about the termination of the contract. As a result, defendant terminated its contractual activity, returned the rented vehicles to plaintiff on 26 September 1995 and in a letter dated 2 October 1995 it terminated the contract with plaintiff with immediate effect, with reference to serious breach of contract by plaintiff in

points of breaching its supply duty. It also claimed compensation under the contract and damages.

Plaintiff in its claim requested defendant to pay 5.470.243.-HUF as due sale-price and late payment interest upon it from 25 September 1995 until payment is made. Defendant did not debate the legal basis or the amount of the claim by plaintiff, but it put forward both a set-off claim and counter-claim. In its view the 5% compensation due under the contract, costs concerning the designation of selling routes and its costs arising in connection with the faulty throwaway advertising material supplied by plaintiff altogether made a claim of 11.918.054.-HUF.

The court of first instance rejected the claim by plaintiff. By accepting the majority of the counter-claim plaintiff was ordered to pay defendant 6.126.517.-HUF and an interest of late payment according to the double of the basic interest of the central bank from 2 October 1995 until payment is made. In the rate of losing the litigation, the parties were ordered to pay for procedural duty, 244.132.-HUF for plaintiff and 19.278.-HUF for defendant. Plaintiff was also obliged to pay for litigation costs of 700.000.-HUF to defendant.

In the legal opinion of the court of first instance, the contract was not terminated by a consensus of the parties, but by a one-sided, prompt and lawful termination of the defendant. One-sided termination was based upon the serious breach of the plaintiff concerning the supply of goods, upon which the claim of contractual compensation of defendant in the amount of 10.851.222.-HUF was rightfully based, and which also gave way to claim for the costs of designating the touring routes in the amount of 745.538.-HUF. The court of first instance did not find the counterclaim of defendant sufficiently established concerning faulty throwaway ads.

Plaintiff appealed to have the judgment changed, to have the counterclaim of defendant dismissed and to claim defendant in the amount plaintiff had put forward. In its reasoning the contract was ended with a mutual consent of the parties, therefore the defendant can not claim contractual compensation and damages for the designation of the touring routes.

The court of appeal did not deal with the part of the judgment which was not appealed against. In the parts which were appealed against it lowered the payment

obligation of plaintiff to 5.390.979.-HUF and interest as outlined in the first instance judgment. Procedural costs to be paid by plaintiff were lowered to 660.000.-HUF and prodecural duties to be paid to the state were lowered to 99.398.-HUF for plaintiff and increased to 64.012.-HUF for defendant. Other than that, the judgment of the court of first instance was not modified. It obliged plaintiff to pay 250.000.-HUF to defendant as procedural costs of the appeal.

The court of appeal agreed with the findings of the court of first instance that the contract was not ended by a mutual agreement of the parties under article 319 (1) of the Civil Code. It was not considered to be a cancellation by conduct that defendant returned the vehicles, the stock of products and other articles and that it did not challenge the amount calculated by plaintiff. In its findings there was no mutual agreement between the parties concerning the cause of the termination of the activity and its legal consequences. In the lack of an agreement concerning the major issues, there was no agreement between the parties to terminate the contract. The appellate court agreed with the court of first instance on the merits concerning serious breach by the plaintiff, and as a reason noted that in the introduction of its system in Hungary, the plaintiff did not proceed with the required care. However, the counterclaim regarding the costs of designing the touring routes was not found to be well-founded, since all expenditures in this regard were covered within the due compensation awarded to defendant.

Against the final decision of the appellate court, the plaintiff petitioned for extraordinary review procedure. It requested to have the judgment annulled, to have the counterclaim by defendant dismissed and to order defendant as requested by plaintiff in its original claim. Plaintiff alleged that the judgment by the appellate court was erroneous in points of its breach of contract and in its conclusion that the contract was one-sidedly terminated by defendant. It pointed out that it did not commit the contractual breach it was found to be liable for. It alleged that the contract was not terminated because of any breach but because plaintiff did not accept the proposal by defendant to modify the contract. It stated that on 25 September 1995 the contract came to an end partly upon a written agreement of the parties and partly by conduct. Therefore, the judgment breached articles 319 (2), (2) and 321 (1) of the Civil Code when it concluded that defendant could

one-sidedly terminate an already non-existent contract on 2 October 1995. As a consequence, defendant may not claim compensation under article 11 (2) of the contract.

In the extraordinary review counterclaim submitted by defendant it was requested that the earlier judgment be upheld. Defendant stated, that the court of appeal was correct in its judgment and that the extraordinary review petition by plaintiff can not be successful in challenging the evaluation of evidence either. The judgment of the appellate court rightly found that the contract was terminated by the notice of immediate termination by defendant on 2 October 1995.

The petition for extraordinary review is unfounded.

Article 15 (4) of the franchise agreement concluded on 9 March 1995 stated that the contract and any modification thereof is valid only in writing. According to article 218 (3) of the Civil Code, if a contract stipulates any specific form for its validity, its termination also requires the designated form. However, if the termination of a contract lacks the designated form, the contract is validly terminated if its actual consequences meet the mutual will of the parties.

The court of appeal was correct in finding that under Article 319 (1) of the Civil Code the mutual termination of a contract is also in itself an agreement to which articles 295 (1) and (2) of the Civil Code are applicable, which requires that the parties must agree on all major issues, or on any issue considered to be important by any of the parties. The 26 September 1995 written declaration by plaintiff that it took the vehicles rented by defendant can not be considered any such agreement. As defendant also pointed out in its October 2 1995 termination, this declaration did not contain the legal title of taking over the vehicles. Defendant referred to the compulsory contractual rules of terminating the contract when it called upon plaintiff to make a required statement under Article 11 (1) of the contract. (Taking over of the franchise enterprise of defendant.) The Supreme Court did not agree with the statement of plaintiff in its extraordinary appeal petition that regardless of the written agreement on termination the parties expressed their mutual will to terminate the contract by conduct. Article 15 (5) of the contract excluded the option of termination in this form, stating, that no conduct other than what is permitted by the contract is capable of modifying or terminating the effects of rights and obligations arising from the contract or may introduce new rights or obligations.

Taking into account the above-mentioned provision of the Civil Code, it has to be examined whether the ignoring of the prescribed form of mutual termination led to a situation that, as plaintiff alleged, met the minds of both parties.

Of the record of the case the Supreme Court pointed out that Cs.T., the regional head of plaintiff who proceeded in the course of the "termination" of the contract submitted in witness testimony that upon the alleged termination defendant did not return the tour routing cards to plaintiff which the witness labeled as "problematic" for the future operation of plaintiff. It is not debated either that defendant was not willing to hand over to plaintiff the store in Pécs rented by defendant for the purposes of the enterprise activity even after plaintiff called on defendant to hand it over. Due to the resistance of defendant, plaintiff had to conclude a new rental contract for the store after the one-sided termination of the contract.

With the additional reasons above, the Supreme Court agreed with the lower court that the contract was not terminated mutually on the 26 September 1995.

The right of prompt termination of the contract was contained in Article 13 of the contract, and paragraph (2) of the same article listed cases of serious breach. The agreement also contained a clause that if the contract is terminated due to a default by franchisor, a compensation of a nature of a flat rate is to be paid, specifying also its rate. Both lower courts were right to find that plaintiff breached its obligation under Article 6 of the contract, because contrary to the contract it did not supply defendant with the necessary amount and variety of goods to be traded. The breach is also evidenced by judicial expert opinion and by statements of plaintiff attached under exhibit A/2 by defendant. In these exhibits plaintiff admitted that it was temporarily unable to supply the basic goods to be traded. Since plaintiff did not indicate any alternative source of the goods to defendant, therefore – contrary to the allegation of plaintiff in its extraordinary review petition – it would have been defendant who would have committed a serious breach if it had found an external source of the goods (Article 6 (2) of the contract). Reference by plaintiff to Article 7 (4) of the contract which allowed defendant to obtain goods from an external source mutually selected by the parties in case of force major or unexpected events with equivalent effect was unfounded since not any of the statements by plaintiff indicated that there was a case like force major. The main point of the

franchise agreement is that it is a fundamental obligation of franchisor to provide for an uninterrupted, permanent supply of the products in the same quality and choice to all franchisee enterprises. Therefore, the lower courts were correct in finding that plaintiff could not excuse itself of the legal consequences of the breach of an obligation which was both assumed by plaintiff in the contract and was also considered to be a main obligation of any franchise agreement.

It was unsubstantiated from plaintiff to hold that the judgment of the court of appeal was erroneous in finding that the denial of the modification proposal of defendant was also a breach of contact by plaintiff, supported by the modification procedure of the Hungarian Franchise Association and that it was erroneous for the court to evaluate the decision of the Association as evidence. The procedural principles of free evidencing and free evaluation of evidence under Articles 166 (1) and 206 (1) of the Code of Civil Procedure allow the court to lawfully take into consideration the conclusions of the professional sectoral organization which knows the international franchise system and the fundamental rules of its functioning, and the calling of which is to ensure the proper enforcement thereof in Hungary, when the court concluded that plaintiff failed to apply proper diligence when introducing the franchise system in question into Hungary and when adapting it to the domestic market, and when finding that the franchise contracts by plaintiff were contrary to Hungarian law. Also Article 15 (1) of the franchise contract prescribes the elimination of any condition leading to invalidity. Because plaintiff, without due cause, failed to modify the contract even after several compulsory modification notices of the Hungarian Franchise Association and even after modification initiatives by defendant, failure to agree to modify also led to the obligation to pay compensation under Article 11 (2) of the contract. (The contract was terminated on the default of the plaintiff.) On the above reasons, the lower court therefore lawfully obliged plaintiff to pay flat rate damages under the contract to defendant as requested by the counterclaim.

Accordingly, under Article 275/A of the Code of Civil Procedure the Supreme Court maintained in effect the well-founded and substantially correct judgment. (Legf. Bir. Gfv. IV. 31.792/1998. sz.)