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COMMENTARIES ON RENEUAL MODEL RULES ON EU ADMINISTRATIVE PROCEDURE (BOOK IV – CONTRACTS; CHAPTER 3 – EXECUTION AND VALIDITY OF EU CONTRACTS)

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Book IV – Contracts

Chapter 3 – Execution and Validity of EU Contracts

As the introduction to Book IV highlights, the starting point of the draft is, that the 'life' of the public contracts under the scope of this Book can be divided into three main phases:

- the first is an administrative procedure leading to the conclusion of a public contract;
- the second is the conclusion of the contract;
- the third is the execution and end (expiration) of the contract.

Chapter 3 of Book IV aims to regulate the third phase of the contracts, mainly by the use of substantive legal provisions.

1. General Provisions

1.1. REPRESENTATION OF EU AUTHORITIES AND FORMAL REQUIREMENTS FOR EU CONTRACTS

The concept of EU Authority is defined by Paragraph (5) of Article I-4 of the draft. In principle the term is used for the institutions, bodies, offices and agencies of the EU. This list is in accordance with the wording of the English versions of the founding Treaties (see e.g. TEU Article 13, TFEU Article 15). The Hungarian translation of the founding Treaties however only contains a listing of institutions, bodies and offices.

The institutions of the EU are listed by Article 13 of the TEU as follows:

- the European Parliament
- the European Council
- the Council
- the European Commission
- the Court of Justice of the European Union
- the European Central Bank and
- the Court of Auditors.

The above mentioned seven main institutions of the EU are emphasized by the founding Treaties. In case of the additional elements of the organizational system of the EU, the founding Treaties use the remaining three concepts. For example, the Economic and Social Committee and the Committee of the Regions are referred to as advisory bodies. Similarly, the European Investment Bank and the European Ombudsman are to be regarded as institutions of the EU.

The distinction is less clear in the case of other types of institutions. The website of the EU most commonly uses the term 'agency' for those types of individual institutions that have a certain level of independence (such as the European Police Office – EUROPOL, the European Medicines Agency – EMA, the European Defence Agency – EDA etc.).[1]

Paragraph (1) of Article IV-20 clarifies that the representation of EU Authorities should solely be governed by EU law, even if the contract is solely governed by EU law, or by Member State Law, or by the law of third countries. In this regard the choice of the parties of the applicable law is irrelevant.

As regards Paragraph (2) of Article IV-20 it is justified to highlight – as a starting point – that Article 335 of the TFEU states the following:

[1] For a more detailed description of these organizations see https://europa.eu/european-union/about-eu/agencies_en (Downloaded: 10.08.2017.)

> "In each of the Member States, the Union shall enjoy the most extensive legal capacity accorded to legal persons under their laws; it may, in particular, acquire or dispose of movable and immovable property and may be a party to legal proceedings. To this end, the Union shall be represented by the Commission. However, the Union shall be represented by each of the institutions, by virtue of their administrative autonomy, in matters relating to their respective operation."

Paragraph (2) of Article IV-20 sets up a limit for the representative power of the person representing the EU Authority. If there is any provision pertaining to the form of an EU contract which is laid down in an EU legal act, the power of the person representing the EU Authority will not include the determination of the form of the contract. The explanatory statement to this paragraph of the draft states, that this rule in principle is similar to the German – private law based – regulation of public contracts, where the rights of the representatives of the *Länder* (federated states) are limited by the rules of the federal private law, taking into consideration that the *Land* (one of the federated states) has no legislative power to impose additional formal requirements for public contracts governed by federal private law.

1.2. CLAIMS OF THE EU AUTHORITY IN THE CONTEXT OF CONTRACTS

In relation to this Article it is necessary to refer to Paragraph (1) of Article IV-7 which contains a similar rule. According to Article IV-7, the listed Articles of Book III shall apply to the conclusion of a contract. Since the draft – as referred to previously – makes a clear distinction between the phases in the 'life' of the contract, it is justifiable for Article IV-21 regulating the execution or possible termination of the contract, to once again call upon the relevant rules set out by Book III. The list of the Articles drawn up by Book III is almost identical to the list set out by Article IV-7, the only difference is, that the referral to Article III-6 has been left out from the latter. Article III-6 sets out the specific rules of application procedures, that evidently refers to the phrase preceding the conclusion of the contract.

Similarly to Article IV-7, we shall refer to the following issue: it is questionable, whether obligations regarding procedures with the aim to make individual administrative decisions are enforceable through concluding or executing contracts (in the latter case even in relation to substantive legal rules). In the field of public law relationships, where in certain cases an authority – within the remits of its public authority – may reach a decision that is obligatory for the client, the application of rules that increasingly guarantee the rights of the client, and make the position of the client more favourable, is justifiable to the fullest extent, in order to compensate for the significant inequality between the parties. Would this solution be also justifiable in case of two-sided relationships, in which several aspects are often governed by civil law? Naturally in a vast amount of public contracts the predominance on the side of the authority cannot be disputed (in several cases this occurs due to the public elements of the legal relationship); however, the question whether this could

be compensated by automatically adopting the well-tried elements of the rules of public administration procedures, should be raised.

The explanatory statement attached to this Article also accounts for these questions. Although it states, that according to the drafters' opinion, each decision made by EU Authorities in connection with the performance of a contract, should be in line with the provisions of administrative procedural regulations and the principle of fair administration (good administration). The explanatory statement refers to one of the judgements of the General Court,[2] where the court ruled in Paragraph 245 that:

> "It should be borne in mind that the EU institutions are subjects to obligations flowing from the general principle of sound administration in regard to the public only in the exercise of their administrative responsibilities. On the other hand, when the relationship between the Commission and the applicant is clearly contractual, the latter can complain, in regard to the Commission, only of breaches of the terms of the contract or of the law applicable to it."[3]

Furthermore, the drafters of the Model Rules state that this Article is also not in line with the practice of the European Ombudsman. However, the drafters uphold the statement that the principle of good administration should be applied in relation with the Treaties as well.

The principle is set out by Article 41 of Title V (Citizens' Rights) of the Charter of Fundamental Rights of the EU as follows:

> "1. Every person has the right to have his or her affairs handled impartially, fairly and within a reasonable time by the institutions, bodies, offices and agencies of the Union.
> 2. This right includes:
> (a) the right of every person to be heard, before any individual measure which would affect him or her adversely is taken;
> (b) the right of every person to have access to his or her file, while respecting the legitimate interests of confidentiality and of professional and business secrecy;
> (c) the obligation of the administration to give reasons for its decisions.
> 3. Every person has the right to have the Union make good any damage caused by its institutions or by its servants in the performance of their duties, in accordance with the general principles common to the laws of the Member States.
> 4. Every person may write to the institutions of the Union in one of the languages of the Treaties and must have an answer in the same language."

The title of the Article is also 'Right to good administration'.

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2 Association Médicale Européenne (EMA) v. European Commission Case T-116/11.

3 Available at: http://curia.europa.eu/juris/document/document.jsf;jsessionid=9ea7d0f130d5946b-0b9a7d7e42679a0299f64979afae.e34KaxiLc3eQc40LaxqMbN4PaN0Ne0?text=&docid=145462&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=1688695 (Downloaded: 11.08.2017.)

We can conclude that some of these rights are guaranteed by Article XXIV of the Fundamental Law of Hungary:

> "(1) Everyone shall have the right to have his or her affairs handled impartially, fairly and within a reasonable time by the authorities. This right includes the obligation of such authorities to give reasons for their decisions.
> (2) Everyone shall have the right to demand compensation, as specified in an act of Parliament, for damages unlawfully caused by the authorities in discharging their duties."

Besides that, the principles of the Hungarian Act on the General Rules of Administrative Proceedings and Services (Act CXL of 2004) describe the contents of the client's rights and the obligations of the authority in detail (Articles 1–11).

In addition to the above mentioned rules, the explanatory statement on Articles highlights the following: Article IV-21 does not constitute a legal basis for the contracting parties to challenge the decisions based on Article 263 of the TFEU before the CJEU. This so-called *annulment* or *cassation* procedure means a quasi-constitutional review (with a phrase adopted from the American constitutional litigation: *judicial review)* of EU legal acts, which can lead to the declaration that the acts are void. The draft however does not wish to pre-empt the possibility to enforce Article IV-21 in relation to disputes regarding contracts of courts that generally have the competence to do so.

1.3. DECISIONS OF THE EU AUTHORITY ON AN EXTRA-CONTRACTUAL BASIS

In relation to this Article we shall once again refer to Article 335 of the TFEU, which grants the Union legal capacity to the fullest extent. The explanatory statement attached to this Article of the draft states that the aim of the Article is to handle the uncertainty, that stems from the relationship between the Court's jurisprudence regarding contractual disputes and the enforcement of decisions of the EU Authorities. On the latter issue, the previously cited Article 299 of the TFEU states the following:

> "Acts of the Council, the Commission or the European Central Bank which impose a pecuniary obligation on persons other than States, shall be enforceable.
> Enforcement shall be governed by the rules of civil procedure in force in the State in the territory of which it is carried out. The order for its enforcement shall be appended to the decision, without other formality than verification of the authenticity of the decision, by the national authority which the government of each Member State shall designate for this purpose and shall make known to the Commission and to the Court of Justice of the European Union.

When these formalities have been completed on application by the party concerned, the latter may proceed to enforcement in accordance with the national law, by bringing the matter directly before the competent authority.
Enforcement may be suspended only by a decision of the Court. However, the courts of the country concerned shall have jurisdiction over complaints that enforcement is being carried out in an irregular manner."

According to the draft the Article therefore has a dual aim:

- On the one hand it does not wish to allow the obligatory act of the EU Authority acting within its public authority powers to be challenged/debated by the contractual parties based on the existing contract, and
- on the other hand, it does not wish to provide an opportunity for the EU Authority to use its public authority powers to be exempted from its own contractual obligations.

In relation to this last phrase, the Article states that, if the EU Authority exercises public authority powers unrelated to the contract, the rights of parties under Article 340(2) TFEU shall remain unaffected:

"In the case of non-contractual liability, the Union shall, in accordance with the general principles common to the laws of the Member States, make good any damage caused by its institutions or by its servants in the performance of their duties."

Furthermore, the exercise of public authority powers shall not prevent the enforcement of any claim in relation with EU Authority by the contractor.

Paragraph (2) of this Article aims to clarify a special conjunction: it is possible for an obligation to appear both in a contract and in a different type of public authority act. In this case the fulfilment of the obligation in the public authority act will be equivalent to the proper fulfilment of the contractual obligation.

1.4. REVIEW BY THE EUROPEAN OMBUDSMAN

The institution of the European Ombudsman is of Scandinavian origin, and was established by modelling the national ombudsmen, that operate in most European countries. Among the founding Treaties, Article 228 of the TFEU is the one that contains the detailed rules of the institution, while according to the rules of Articles 20 and 24 of the TFEU, and Article 43 of the Charter of Fundamental Rights the possibility to file a complaint to the Ombudsman shall extend to any person who is a citizen of the Union.

In contrast to those national ombudsmen, whose tasks can be described with specificities related to the general protection of fundamental rights (such as the Hungarian Commissioner of Fundamental Rights), the centrefold of the European Ombudsman's activity is

the issues concerning the so-called *maladministration*.[4] In the absence of a normative definition, the content of this concept was explained by the Ombudsman himself: the term *maladministration* can – among others – mean the infringements of administrative rules, the unfair or discriminative conduct during the procedure, the abuse of power, the withhold of information or the unjustifiably prolonged decision making.[5]

The Ombudsman – similarly to the national ombudsmen – has widespread investigatory powers, while he/she cannot exercise public powers. In disputed cases the ombudsman aims to facilitate consensus, or allowed to make recommendations and proposals, furthermore submits reports to the European Parliament. The Ombudsman is allowed to examine the conduct of any EU institution, body, office or agency, except for the judicial activity of the Court.

The scope of the Ombudsman's investigatory activity includes the procedures that are related to public contracts concluded by EU institutions, bodies etc. In this however, the practice of the commissioner shows a certain amount of self-moderation, due to the fact that contractual disputes (i.e. questions of substantial legal nature) are most likely to be resolved before courts. The Ombudsman therefore only examines the issues that are related to procedural matters concerning the contracts (e.g. whether the plaintiff's right to be heard has been ensured during the enforcement of the contract, or whether the parties have been granted access to all information etc.).[6]

Article IV-23 of the draft refers back to the rules of fair administration set out by Article IV-21, meanwhile it sets out that, the scope of review by the Ombudsman includes the fulfilment obligations arising from EU contracts. It seems questionable whether the expansion of the scope of review by the Ombudsman could result in a problem of collision of rules in cases of judicial settlement of contractual disputes, although Paragraph (2) of the Article makes it clear, that the recommendation issued by the European Ombudsman does not affect the right of the parties to have their contractual dispute examined by a court (or arbitration tribunal). The issue may rise whether the recommendation of the Ombudsman could be taken into consideration by the acting court.[7]

Nonetheless, Paragraph (3) of the Article states, that an instance of *maladministration* on the part of the EU Authority revealed by the inquiry does not affect the validity of the

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4 For a more detailed information on the institution of the Ombudsman, its functioning and the complaint options see the website of the European Ombudsman: www.ombudsman.europa.eu/en/home.faces (Downloaded: 13.08.2017.)

5 For more detail see Kende Tamás – Szűcs Tamás – Jeney Petra eds. (2007): *Európai közjog és politika. (EU Law and Politics.)* Budapest, CompLex Kiadó. 342.

6 Some cases related to contracts can be found in the report of the European Ombudsman for 2012, pages 46–48. Annual reports on the website of the Ombudsman: www.ombudsman.europa.eu/activities/annualreports.faces (Downloaded: 13.08.2017.)

7 Since Model Rules – in their current form – do not wish to regulate issues concerning judicial procedures, this issue will only be resolved by examining the future practice of the courts – provided that the draft will be accepted in its current form. For further details see the comment of András Varga Zs. on this issue in: Varga Zs. András (2014): Gyorsértékelés az európai közigazgatási eljárási modell-szabályokról. (Preliminary Assessment of the Model Rules on EU Administrative Procedure.) *Magyar Jog,* 2014/10. 549.

contract or the validity of the claims. Meanwhile the paragraph states that the remedy of the *maladministration* would be mandatory for the EU Authority and specifies the following three methods to do so:

- the Authority may use its contractual powers (for example in order to offer modification or termination),
- the Authority may accept offers from the contracting party to re-negotiate or modify the respective contract,
- the Authority may offer financial compensation.

The draft does not set up an order between the considerable options, nor define any assessment criteria. It would seem expedient to include such a measure in the text because the current situation would offer for an interpretation which would allow the Authority to choose between the measures based on its discretional power, indifferent to the solution which would be more favourable for the other contracting party. Such a one-sided decision which could be even detrimental for the other contracting party is not a favourable solution, because it would serve as a ground for filing another complaint to the Ombudsman.

1.5. ARBITRATION CLAUSES

Arbitration procedures traditionally serve as faster and more successful alternatives of settling private legal disputes, rather than forms of judicial dispute resolution.[8] Such an option is present in the TFEU, when in Article 272 it stipulates that:

> "The Court of Justice of the European Union shall have jurisdiction to give judgment pursuant to any arbitration clause contained in a contract concluded by or on behalf of the Union, whether that contract be governed by public or private law."

It has to be noted, that TFEU does not allow using the 'traditional' method of arbitration (where the parties choose the members of the tribunal), because in the case of EU contracts, one of the Union's courts will be the acting court.

As it has been noted several times already, the draft makes a distinction between the contracts to which the EU law shall be applicable and to which the national law of the Member States (or third countries) shall be applicable. Paragraph (1) of Article IV-24 clarifies that

[8] On the theoretical basis of arbitration see Horváth Éva – Kálmán György (2003): *Nemzetközi eljárások joga – Kereskedelmi választottbíráskodás. (Law of International Procedures – Commercial Arbitration.)* Budapest, Szent István Társulat. 54–63.
The Hungarian model of arbitration is regulated by Act LXXI of 1994 on Arbitration. As a general rule instead of the court of law, disputes may be settled by way of arbitration if: a) at least one of the parties is professionally engaged in business activities and the legal dispute arises out of or in connection with this activity; b) if the parties may dispose freely of the subject-matter of the proceedings; and c) if the arbitration was stipulated in an arbitration agreement [Article 3 Paragraph (1)].

validity of arbitration clauses within the meaning of TFEU should be interpreted in line with the EU law. When the arbitration clause is valid, only the CJEU has jurisdiction, even if the applicable national law conflicts with these jurisdiction rules.

According to the draft, the arbitration clause always has to be concluded in a written form, however, it should be possible to fulfil this criterion by drafting another document that contains a written arbitration clause, following the conclusion of the contract. In the absence of a written arbitration clause, the draft would establish an irrefutable presumption that there is no arbitration clause. This presumption would serve as a guideline for the judicial interpretation. (According to the explanatory statement to this paragraph, there is a need to terminate the judicial practice which allows the parties to make up for the written clause with a concordant verbal statement. This rule would protect the party entering to a contract with an Authority, and could prevent the contractor to enter an arbitration procedure due to the fear of having sued in a 'normal' judicial procedure.)

Paragraph (2) of this Article sets out a significant time limit: the arbitration clause can be concluded until the initiation of court proceedings. The submission of the lawsuit is a legal statement, which allows one of the contracting parties to declare to initiate a proceeding before a 'normal' court that has jurisdiction rather than an arbitration tribunal.

Paragraph (3) of the Article would grant an outstandingly prominent position for the party entering into a contract with the EU Authority upon allowing him – if three criteria are met – to request the mandatory annulment of the arbitration clause. The first instance (a) would apply to cases where the contractor did not have the opportunity to make a choice when negotiation an arbitration clause (i.e. the arbitration clause was part of the general terms and conditions of the contract). The second instance (b) would apply to cases where there is a 'more appropriate jurisdiction' compared to the jurisdiction of CJEU. The third instance (c) would create an opportunity for the contractor to modify his original choice and initiate a proceeding before a 'normal' court.

Analysing the second instance and the last sentence of Paragraph (3) we can conclude that the draft aims to regulate a model, which allows the contractor to refer to the existing reasons while the EU Authority is allowed to make a decision to annul the clause. If it does not grant the contractor's request it is obliged to justify its statement (see also Article III-29).

The explanatory statement to this Article highlights that if there is a valid arbitration clause, the CJEU will be under the necessity to take the place of national courts, whenever the chosen legal system is of one of the Member States. In the absence of an arbitration clause (or if the clause proves to be invalid, or gets annulled at a later stage), only the national courts shall have jurisdiction according to TFEU Article 274:

> "Save where jurisdiction is conferred on the Court of Justice of the European Union by the Treaties, disputes to which the Union is a party shall not on that ground be excluded from the jurisdiction of the courts or tribunals of the Member States."

In such cases the interpretation of the contract and the determination of its validity will be the task of the national judge,[9] since this power can not revert to the CJEU, not even in a preliminary ruling procedure.

1.6. EXCLUSION OF COMPENSATION

The explanatory statement attached to this Article highlights that this rule is of fundamental significance (a general clause). Its main purpose is to exclude the EU Authority from under the rules of compensation (generally compensation is a form of financial contribution) regulated in the later Articles of this Chapter.

This paragraph is a verbatim copy of the list that can be found in Article 48 Paragraph (2) of the German Administrative Procedure Act.[10] The Act in principle allows omitting the withdrawal of the unlawful administrative acts in the case of financial allowances; however, the listed cases constitute a ground for withdrawal and the client cannot plead that he trusted the validity of the act in good faith. This legal instrument is similar to the Hungarian Administrative Procedure Act's principal instrument known as the protection of the rights of clients acquired and exercised in good faith.

It is obvious that the behaviours listed in Article IV-25 are unlawful or are exercised in bad faith, where – as a sanction – the contractor who concluded a contract with the EU Authority will be deprived from gaining financial compensation.

2. EU Contracts Governed by EU Law

2.1. EXECUTION AND PERFORMANCE

2.1.1. Good Faith and Fair Dealing

In contractual law the principle of good faith and fair dealing is generally accepted (a general clause) all over the world. Good faith is a conscious (subjective) state, based on a statement which is subjectively considered to be true by the person making it (and even if it is untrue, the person making the statement should not have a knowledge of this). In legal terms good faith refers to a situation in which someone believes that his actions are lawful – and if they are not he should have no knowledge about the unlawfulness of his actions.

The term good faith has its origins in Roman law *(bona fides).* An interesting fact is that it was originally an objective state, so the concept was not about a person's inner conviction

[9] On the same issue see Regulation (EU) No. 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters. [The Regulation replaced Council Regulation (EC) No. 44/2001 on 10 January 2015.]

[10] *Verwaltungsverfahrensgesetz* (1976).

but about an action that is detectable by the external world (like reliability or trustworthiness). The opposite of good faith is bad faith *(mala fides).*

The principle of good faith (and fair dealing) can be found usually at the beginning of the modern civil codes. It can be found among others in the German, Austrian, Swiss, Dutch and French codes *(Treu und Glauben, bonne foi).*[11] The principle has moral foundations and may consist of several elements; it may mean justice, contractual loyalty, equity, morality, trust, etc.[12]

Also, the Hungarian Civil Code (Act V of 2013) states that in exercising rights and in fulfilling obligations the requirements of good faith and fair dealing shall be observed [Article 1:3 Paragraph (1)].

The draft prescribes the obligation to exercise this principle for every behaviour related to the third 'life phase' of the contracts. Besides this, it highlights that this moral principle is so significant that the general rules of contractual freedom do not affect it, meaning the principle of good faith and fair dealing can not be excluded or limited by contract.

2.1.2. Contractual Rules

This Article would create an obligation for the contracts solely governed by EU law to contain a provision that should specify a mandatory background regulation for issues that are not covered by the rules of Article IV-4 of the draft. The completion of this so-called mandatory choice of the applicable law should be ensured by the EU Authority. This however relativizes the 'exclusiveness' of EU regulation.

The explanatory statement to this Article states that the clause should make clear:

- if the clause refers to the common contract law of the relevant Member State, or
- if the EU Authority may avail itself of the specific privileges granted to public authorities in the contractual law of the relevant Member State, or
- if the contract should be treated like a contract governed by public law of the relevant Member State.

In order to ensure uniformity, the draft would prescribe that the chosen law of obligations (model rules) shall be mandatory in the future and shall be applicable to all future contracts serving the same purposes.

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[11] Földi András – Hamza Gábor (2000): *A római jog története és institúciói. (The History and Institutes of Roman Law.)* Budapest, Nemzeti Tankönyvkiadó. 176–177.

[12] Lábady Tamás (2000): *A magyar magánjog (polgári jog) általános része. [General Provisions of the Hungarian Private Law (Civil Law)].* Budapest–Pécs, Dialóg Campus Kiadó. 137–138. Lábady refers to the fact that in German law, the principle of *gute Sitten* (good morality) is a general principle of the same importance as *Treu und Glauben*.

The explanatory statement to this Article also highlights that, instead of referring to the contractual law of a Member State, the contract may refer to international model codes (such as the DCFR or the principles of UNIDROIT).[13]

2.2. CHANGE OF CIRCUMSTANCES AND RELATED CLAUSES

2.2.1. Change of Circumstances

The use of the clause referring to the change of circumstances *(clausula rebus sic stantibus)* is an ancient legal instrument, such as the rules of exclusion of contractual obligations.[14] If one of the parties' position becomes so much more burdensome – without any fault on his part – that the completion of the contractual obligations cannot be expected from him/her, the principle 'agreements should be kept' *(pacta sunt servanda)* shall not apply.[15]

The draft creates a verbatim copy of the phrase found in Article 60 Paragraph (1) of the German Code of Abedministrative Procedure. The German act allows the modification or if necessary the termination of public contracts.

The Hungarian Code of Administrative Procedure applies a similar approach when it sets out in the Article regulating public contracts that:

> "Article 77 (1) The amendment of the resolution may be requested by either party if any new circumstance that is deemed significant for the purposes of the case arises or if the conditions existing at the time of the signature of the agreement have changed significantly."

The courts often have remit to modify private contracts. The explanatory statement attached to the Article cites Article III-1:110 of DCFR, to prove its statement, but the Hungarian Civil Code can also be cited:

> "Article 6:192 [Amendment of contract by the court]

[13] UNIDROIT is an intergovernmental organization based in Rome, which, as an international institute, aims to harmonise private law (primarily the law of international trade relationships). The organization published the Principles of International Commercial Contracts. The application of the Principles can be set out by contracting parties (EU and other countries alike). See in more detail Bánrévy Gábor (2003): *A nemzetközi gazdasági kapcsolatok joga. (Law of International Trade Relationships.)* Budapest, Szent István Társulat. 25–26.

[14] In classic Roman law the principle was unknown, it was established later during the subsequent fate of Roman Law.

[15] An interesting fact is that the original text of the Hungarian Code of Administrative Procedure, containing mainly imperative provisions, used a similar legal instrument. The former Article 113 of the Act stated that, if the enforcement of the final administrative decision would constitute an unreasonably heavy burden for reasons that have occurred after the decision was adopted, and if special consideration was not allowed in the enforcement procedure, the client had the right to request the revision or withdrawal of the lawful decision via a procedure in special consideration. This procedure was regarded as a special legal remedy; however, these rules were repealed in 2009.

(1) Either of the parties shall be entitled to request to have the contract amended by court order if in the long-term contractual relationship of the parties performing the contract under the same terms is likely to harm his relevant lawful interests in consequence of a circumstance that has occurred after the conclusion of the contract, and:
a) the possibility of that change of circumstances could not have been foreseen at the time of the conclusion of the contract;
b) he did not cause that change of circumstances; and
c) such change in circumstances cannot be regarded as normal business risks.
(2) The court shall have powers to amend the contract as of the date it has determined, at the earliest from the date of enforcement of the right to amend the contract before the court, in a manner to ensure that neither of the parties should suffer any harm in their relevant lawful interests in consequence of any change in the circumstances."

The drafters of the Model Rules claim that in the case of EU contracts it would be more advantageous to apply the German solution because by those rules mandatory judicial proceedings could be avoidable.

2.2.2. Termination to Avoid Grave Harm to the Common Good

The one-sided termination of the contract by the authority is not an unknown instrument even in the French or the German law. The previously cited Paragraph (1) of Article 60 of the German Code of Administrative Procedure also allows the use of it.

The term *'common good'* – which has no normatively defined meaning – creates broad discretional power, the content of which may be defined by state organs, primarily those that are within the executive branch. In the Hungarian legal terminology the term *'public interest'* appears with a similar substance.[16] The rules of the Hungarian Code of Administrative Procedure set out that one of the conditions to enter into a public contract (a so-called administrative agreement) is to settle the case with a resolution that is best suitable for the public.

Possibly due to the above mentioned reason, the explanatory statement attached to this Article only acknowledges the reason for termination mentioned by the Article, as an exceptional, *ultima ratio* instrument in accordance with the German rules, although there are no practical experience regarding its usage.

[16] Lajos Lőrincz thinks that only the Government has the remit to define the concept of public interest, due to its power to conduct oversight on a national level. However, the *representation* of public interest is an obligation for all public administration bodies. See Lőrincz Lajos (2010): *A közigazgatás alapintézményei. (Fundamental Institutions of Public Administration.)* 3rd edition. Budapest, HVG-ORAC. 78.

2.2.3. Termination for Non-Performance

This Article mostly takes over Articles III-3:502-505 of DCFR.

In line with the *pacta sunt servanda* principle one of the main objectives of the contracts is to facilitate the completion of obligations. It is a general rule in contractual law, that the failure to perform – or the inadequate completion of – the undertaken obligations is regarded as defaulting behaviour. (In case of a fundamental change in circumstances, the modification of the contract may be requested. Besides the contracting parties can modify the contract any time, because modification is governed by the principle of the parties' contractual freedom.)

The consequence of the *non-performance* of one of the parties creates a right for the other contracting party to terminate the contract with a one-sided statement. However, it is expected for the non-performance to be *fundamental*. Paragraph (1) of the Article lists – in general – the possible cases.

If the non-performance affects an obligation that is *not fundamental,* the contract shall only be terminated on the grounds of delay in performance if the person in delay has been granted an additional period of time of reasonable length for performance and the debtor does not perform within that period.

The draft does not exclude the option of terminating the contract before the performance of a contractual obligation is due, if the non-performance of the debtor in a fundamental obligation can be unequivocally expected (e.g. if the debtor has declared that there will be a non-performance of the obligation, or if the debtor does not provide an adequate assurance).

The consequence of non-performance beyond the above mentioned is a right to seek damages, if the defaulting action has caused damage. The draft makes it clear that, the right to seek damages is not excluded by the termination of the contract.

The explanatory statement attached to this Article points out that in this case substantive provisions have been created (and been taken over) as well. The aim of this is not to define new substantive law for EU contracts, but to stick to the rules necessary for the administrative procedure of conclusion and execution of EU contracts.

2.3. CONSEQUENCES OF ILLEGALITY AND UNFAIR TERMS

2.3.1. Termination Due to an Infringement of the Provisions of Chapter 2

The Article regulates a method of contract termination which is of penalizing nature and may only be exercised by the EU Authority. The termination may occur for two reasons:

- in line with Paragraph (4) of Article IV-8 of the draft, if the CJEU has rendered the EU Authority's decision in which the contract was concluded void (this however does not affect the extra-contractual liability of the EU Authority);

- if the EU Authority becomes aware that the rules on the procedure regarding the conclusion of an EU contract have not been respected to the detriment of a third party.

In the first instance there is a judicial decision which leaves no room for discretional power. In the second instance the EU Authority will be in a position where it has discretional power, because it has to assess if there is a case of infringement and detriment of a third party.

In both instances, the termination of the contract is not necessarily equal to the final termination of the legal relationship, because the procedure that leads to the conclusion of the contract shall be restarted after the termination. In the new procedure the decision of the Court should be taken into consideration and/or the rules of the procedure to conclude a contract should be ensured.

It should be noted, that the draft does not name termination as a mandatory instrument, it is merely an optional solution (Article IV-8 allows the modification of the contract as well).

The termination has no retroactive effect; it only applies to future purposes. (So the legal instrument of *withdrawal* known by the Hungarian civil law cannot be used, not even if the service is otherwise reversible.)

Paragraph (2) of the Article lists the exceptions from this general rule, where the EU Authority can not exercise its right of termination. The draft however does not forbid the possibility of the modification of the contract in such cases.

Paragraph (4) would prescribe an obligation for the EU Authority to compensate the other party for disadvantages, suffered due to reliance on the existence of the EU contract. In this case the party's good faith and fair dealing shall also be assessed. The amount of compensation shall not exceed the benefits achieved by the fulfilment of the original contract – this would mean that the contracting party would receive the money or service set out in the contract, without actually not or only partially fulfilling the contract. (If the main obligations were wholly or mostly completed, there is no place for the termination of the contract.)

In the explanatory statement the drafters note that, this provision seems to be considered as common sense among scholars and they refer to the provisions of two EU Directives on public procurement that regulate the criteria of invalidity and termination of contracts.

The first cited EU legal instrument is Council Directive 89/665/EEC of 21 December 1989 on the coordination of the laws, regulations and administrative provisions relating to the application of review procedures to the award of public supply and public works contracts. Article 2d of this Directive has detailed rules of the instances of ineffectiveness of contracts based on the decision of an independent review body. Such a case is, for example, when the obligation for a prior publication of a contract notice was breached, or for example when the tenderer could not exercise its right to pre-contractual remedy. Furthermore, the Directive allows the Member States to prescribe the cancellation of contractual obligations with a retroactive effect.

The second citation refers to Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repealing Directive 2004/18/EC, more precisely to its Article 73. This – similarly to the rules of the draft – allows the contracting authorities under certain conditions to terminate a public procurement contract.

2.3.2. Renegotiation Due to an Infringement of the Specific Obligations of EU Authorities as Public Authorities

This Article contains the cases of renegotiation of contracts due to specific cases of infringement, which can be requested by any of the contracting parties. It must be highlighted that the draft does not promote automatic invalidity of a contract in the case of the specified cases of infringement, rather it aims to provide the contracting parties with an option to renegotiate the contract.

However, it is also possible to terminate the contract. In this instance the draft does not use the term 'termination' which can lead us to the conclusion that – similarly to the Hungarian law – the 'cancellation' presupposes the joint will and agreement of the contracting parties.

The draft would allow the cancellation in parallel with compensation and also without compensation. There is but one exception when a competitive award procedure was applicable to the contract (Chapter 2, Section 3), because in this case compensation is obligatory.

The explanatory statement attached to this Article highlights that the Article aims to regulate an issue which does not appear commonly in the Member States' law, and is not commonly discussed among scholars and in judicial practice. The drafters think that it would be expedient to implement the French legal formulas in this regard.

2.3.3. Invalidity

Invalidity is a sanction which terminates the exercise of rights and fulfilment of the obligations due to some kind of grace infringement and regarding the services already provided – as a general rule – aims for the restoration of the original state *(in integrum restitutio).*

In Hungarian law invalidity has traditionally two forms, nullity and avoidance. The theoretical difference between the two instruments is, that in case of nullity the contract is invalid by operation of law *(ipso iure),* while in case of avoidance the invalidity can only be determined if the contract has been successfully avoided. It is a common feature of the two instruments, that – taken into consideration that the reason of invalidity was present when the contract was concluded – the invalidity of the contract has a retroactive effect, starting from the outset of the conclusion of the contract *(ex tunc).*

The draft only discusses the issue of invalidity in a laconic manner – taking into consideration that it considers the previous Article as the "general rule" and the determination of invalidity only as a final solution. The draft only considers an EU contract invalid if:

- an equivalent contract between private persons would be considered invalid and thus not binding in accordance with the general principles common to the laws of the Member States; or
- a single case decision of the EU Authority with equivalent content would be nonexistent.

The draft would also set out that each party may request the other party to confirm the invalidity. This solution would allow the application of legal consequences without having a prior authority or judicial decision.

The '*general principles common to the laws of the Member States*' is a phrase used by Article 340 of TFEU, the content of which should be interpreted mainly by the Court.

2.3.4. Unfair Terms

Regarding the unfair contractual terms, the draft only contains a rule that refers to another piece of legislation. According to the explanatory notes to this Article of the related pieces of EU legislation, the role of *Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts* has to be emphasized. Article 3 of this Directive sets out, that a contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer. The Annex to the Directive contains a wide illustrative list of the examples of unfair terms.

For example such terms fall under this category, that bear the following subject of effect:

- excluding or limiting the legal liability of a seller or supplier in the event of the death of a consumer or personal injury to the latter resulting from an act or omission of that seller or supplier;
- inappropriately excluding or limiting the legal rights of the consumer vis-à-vis the seller or supplier or another party in the event of total or partial non-performance or inadequate performance by the seller or supplier of any of the contractual obligations, including the option of offsetting a debt owed to the seller or supplier against any claim which the consumer may have against him;
- making an agreement binding on the consumer whereas provision of services by the seller or supplier is subject to a condition whose realization depends on his own will alone;
- permitting the seller or supplier to retain sums paid by the consumer where the latter decides not to conclude or perform the contract, without providing for the consumer to receive compensation of an equivalent amount from the seller or supplier where the latter is the party cancelling the contract;
- requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation;
- authorizing the seller or supplier to dissolve the contract on a discretionary basis where the same facility is not granted to the consumer, or permitting the seller or supplier

to retain the sums paid for services not yet supplied by him where it is the seller or supplier himself who dissolves the contract;
- enabling the seller or supplier to terminate a contract of indeterminate duration without reasonable notice except where there are serious grounds for doing so;
- irrevocably binding the consumer to terms with which he had no real opportunity of becoming acquainted before the conclusion of the contract;
- enabling the seller or supplier to alter the terms of the contract unilaterally without a valid reason which is specified in the contract;
- providing for the price of goods to be determined at the time of delivery or allowing a seller of goods or supplier of services to increase their price without in both cases giving the consumer the corresponding right to cancel the contract if the final price is too high in relation to the price agreed when the contract was concluded;
- obliging the consumer to fulfil all his obligations where the seller or supplier does not perform his;
- excluding or hindering the consumer's right to take legal action or exercise any other legal remedy, particularly by requiring the consumer to take disputes exclusively to arbitration not covered by legal provisions, unduly restricting the evidence available to him or imposing on him a burden of proof which, according to the applicable law, should lie with another party to the contract.

In order to properly implement the rules of the Directive, the Hungarian Civil Code adopted a very similar regulation (Articles 6:102–104).

3. EU Contracts Governed by Member State Law

As referred to this fact previously, EU contracts may be under the scope of EU law, or one of the Member States' law or eventually under the scope of a third country's law. Section 3 contains the rules of EU contracts governed by Member State law.

3.1. APPLICABLE LAW

Since in the case of these EU contracts the law of one of the Member States has to be used, Paragraph (2) of this Article sets out that, if an EU contract infringes EU law, this shall not be considered a ground for invalidity or termination of the contract if a similar contract concluded between private parties would be considered valid and binding in accordance with the applicable Member State law. In other words, the parties' freedom to conclude contracts may hinder the principle of primacy of EU law.

Paragraph (3) of this Article refers to Paragraph (2) of Article IV-5. The paragraph referred to sets out, that the applicability of a Member State law to an EU contract cannot relieve the EU Authority of its obligations to comply with its public law obligations in

accordance with the founding treaties and other EU legal instruments. Therefore, if the EU Authority acts otherwise, but the relevant Member State law does not restrict it to exercise its contractual rights resulting from the contract, the EU Authority cannot be exempted from its obligations regarding the conclusion or renegotiation of the contract or regarding compensation.

This provision is similar to one of the general principles known in private law, according to which no one can invoke his own faulting (often illicit) behaviour in order to gain advantage *(nemo suam turpitudinem allegans auditur* – in Hungarian law see: Civil Code Article 1:4). If one of the contracting parties could demand the fulfilment of the contractual obligations from the other party regardless of his faulting behaviour, the principles of good faith and fair dealing – among others – would be infringed.

3.2. CONTRACTUAL CLAUSES FOR COMPLIANCE WITH EU LAW

This Article also aims to protect the rights of the party entering into contract with an EU Authority, and its objective is to prevent the Authority to exercise its public powers in an abusive manner. However, the validity of the related guarantees defined by this Article shall be determined in accordance with the applicable Member State's law instead of the EU law. It shall be regarded in this instance, that the party entering into contract with an EU Authority shall also act in good faith and show fair dealing.

MAIN ABBREVIATIONS

CJEU – Court of Justice of the European Union
TEU – Treaty on European Union
TFEU – Treaty on the Functioning of the European Union

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