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Termination for compelling reason (*)

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(*) Cf. Study L – Doc. 127, Issue (h).

SECTION 3: TERMINATION FOR COMPELLING REASON

ARTICLE 6.3.1

(Right to terminate for compelling reason)

(1) A party may terminate a long-term contract if there is compelling reason for doing so.

(2) There is compelling reason only if, having regard to all the circumstances of the case, it would be manifestly unreasonable for the terminating party to be expected to continue the contractual relationship.

(3) The right of a party to terminate the contract is exercised by notice to the other party.

(4) Termination of the contract for compelling reason takes effect as from the time of notice.

COMMENT

1. Compelling reason

In the case of long-term contracts, particularly those characterised by an ongoing relationship of cooperation and trust between the parties, events may occur which lead to a breakdown of that relationship. When that is the case, the contract may be terminated. The right of termination under this Article is an exceptional remedy that can be resorted to only if the breakdown of the relationship is irreparable. The decisive test is whether it would be manifestly unreasonable for the terminating party to be expected to continue the contractual relationship. This has to be determined by taking into account all the circumstances of the case. The reason to terminate, in other words, has to be compelling.

2. Termination for compelling reason and other provisions dealing with termination

The Principles include other provisions dealing with termination, but those provisions do not specifically address the situation where there is an irreparable breakdown in the relationship between parties to long-term contracts. Thus, termination for compelling reason is not available in cases of hardship because a fundamental alteration of the equilibrium of the contract, as envisaged by Article 6.2.2, does not involve an irreparable breakdown of the contractual relationship. In cases of hardship the disadvantaged party is entitled to renegotiations (see Article 6.2.3). Such renegotiations, in turn, would be meaningless if the breakdown is irreparable. Force majeure, under the Principles, does not give rise to a right of termination. The effect of force majeure is that it excuses the non-performing party from liability for damages (see Article 7.1.7). The mere fact that a party is prevented from performing as a result of an impediment beyond its control does not constitute compelling reason to terminate under this Article.

It is neither necessary, nor sufficient, for one party to be in breach of contract for the other to be granted a right to terminate for compelling reason. In cases of fundamental non-performance by one party, the other has a right to terminate under Article 7.3.1. If there also exist circumstances which make it manifestly unreasonable to continue the relationship, then that party will also be able to terminate for compelling reason.

Illustrations

1. A, a manufacturer in country X of sophisticated machines for large volume mailings, appoints B as its exclusive distributor in country Y for a term of fifteen years. Ten years later, B is sold to C, which is a long-time direct competitor of A and, as a consequence of the sale of B to C, C would gain access to A's confidential customer information and customers in country Y. In these circumstances, it would be manifestly unreasonable to expect A to continue the distribution agreement with B. A may therefore terminate that contract for compelling reason.

2. Following its worldwide expansion into both the auditing and consulting business, Company A decides to split its activity into two business units, X and Y: X concentrating on the auditing business and Y concentrating on the consulting business. By an agreement, X and Y undertake, among other things, to coordinate their business practices so as to avoid undue overlap. Over the years, however, the relationship between the two business units deteriorates. X, attracted by the increasingly favourable prospects of the consulting business, begins to develop its own consulting practice, while Y complains that such behaviour constitutes undue interference with its own professional practice. There are numerous failed attempts to resolve their differences. In such circumstances either of them can terminate the agreement because it would be manifestly unreasonable for them to continue the contractual relationship due to their irreconcilable differences as to the precise scope of their respective business practices.

3. A, a software development company, enters into a co-operation agreement with B, another company developing software, to collaborate to produce software programmes for games on smartphones. A finds that its costs of employing software developers increase dramatically because of a shortage of specialist developers resulting from the growth in the smartphone game market. As a result, the profits made by A under the co-operation agreement decrease significantly. Whilst A may be able to demand renegotiation of the contract if the requirements of Article 6.2.2 are met, it is not manifestly unreasonable to expect A to continue the co-operation agreement and, therefore, A cannot terminate that agreement for compelling reason.

4. C and D are companies who form a joint venture agreement to develop a chain of luxury hotels. They agree to provide financing in equal shares but C is finding it difficult to raise capital to meet its financial commitment. The chain of hotels therefore cannot be developed. Whilst D may be able to invoke the provisions on termination for fundamental non-performance under Article 7.3.1, it is not manifestly unreasonable to expect D to continue the joint venture agreement. D cannot, therefore, terminate the agreement for compelling reason.

3. Inappropriate termination for compelling reason

If a party gives notice of termination under this Article without there being compelling reason, this may constitute anticipatory non-performance. The other party may then terminate the contract for fundamental non-performance under Article 7.3.3. Alternatively, that party may keep the relationship alive and withhold its own performance under Article 7.3.4.

4. Non-mandatory nature of right to terminate

The provisions on termination for compelling reason, in line with the general principle laid down in Article 1.5, are not of a mandatory character. The parties may thus exclude or limit their application. They may also indicate in their contract specific cases, which entitle a party to terminate for compelling reason.

5. Termination by notice

The right of a party to terminate a contract for compelling reason is exercised by giving notice to the other party. Termination takes effect as from the time of notice. The notice is effective when the other party receives it (see Article 1.10).

ARTICLE 6.3.2

(Effects of termination for compelling reason)

As to the effects of termination of a long-term contract for compelling reason in general, and as to restitution, the provisions in Articles 7.3.5 and 7.3.7 apply.

COMMENT

The effects of termination for compelling reason in general are those set out in Article 7.3.5. Both parties are released from their obligation to render and to receive future performance.

The fact that, by virtue of termination, the contract is brought to an end does not deprive a party to the contract of its right to claim damages for any non-performance.

Termination also does not affect any provision in the contract for the settlement of disputes or any other term which is to operate even after termination (see Comments 3 and 4 on Article 7.3.5).

Performance of a long-term contract might have been made over a long period of time before the contract is terminated for compelling reason. This may make it inconvenient to unravel such performance. Furthermore, termination is a remedy with prospective effect only. Restitution can, therefore, be claimed only in respect of the period after termination. This is set out in Article 7.3.7(1), with the consequence that, as far as restitution has to be made, the provisions of Article 7.3.6 apply as set out in Article 7.3.7(2).