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A few words about the "termination clauses/covenants" in commercial contracts[1]

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No doubt, the subject was treated many times and from multiple perspectives in the specialized literature. However, the frequency with which many persons, not only those without legal training but also a large and worrying number of practitioners prove that they do not master the "termination clauses" legal institution, convinced us to dedicate this month's article to the issue of "termination clauses/covenants", namely to how they should be drafted when concluding a commercial contract.

We want to mention from the very beginning that this article is not meant in any way to be a theoretical approach, loaded unnecessarily with strict legal terminology and reasoning, but rather an effort with a practical ending and with the purpose to help readers of this article to avoid unnecessary or inefficient termination clauses in commercial contracts and to insert in such contracts termination clauses that would be really helpful in the event of infringement or breach of contract done by their contracting partners.

Therefore, we decided to structure this article into two parts, namely (I) a short theoretical presentation of the institution "termination clauses", particularly of the clauses contained in commercial contracts and (II) a brief analysis of some of the termination clauses we encountered in our work.

I. Brief overview of the types of termination clauses.

The termination clause or covenant is a doctrinaire creation, which has not found until this time, express regulation in the Roman Civil Code (as it still is in force). As it was defined, the termination clause is the contractual clause through which the parties stipulate that, in case of un-performance (or improper performance) of obligations made by one party (the debtor), the contract will be terminated by the court of law, upon the request of the other party (creditor).

It should be noted from the outset that the creditor's possibility to request and obtain termination of the contract for failure to respect the obligations by the debtor is established by Articles 1019 - 1021 of the Civil Code, even in the absence of a contractual provision in this regard. However, the principle of mutual consensus that governs the relationships of private Romanian law can

[1] This article does not represent, and cannot be considered as, a legal opinion rendered within a client-attorney relationship. As well, this article took into consideration the contents of the legislation dealt with, as it was in force at the date the article was prepared and published within *Consulting Review Magazine* (August 2009 issue - http://www.consultingreview.ro/revista_tiparita/articol/august-2009/pactele-comisorii-in-contractele-comerciale.html) and therefore some of the information contained herein might not be up to date. For updated, more detailed information and/or attorney-client assistance, please contact us. The original article may have suffered some adaptations due to legal English translation process.

leave the parties the possibility to particularize the termination clauses or covenants in their contract, especially on how, and as of which date, such termination shall operate.

Therefore, the specialized literature has identified four types (degrees) for different termination clauses, classified according to the "severity" put in sanctioning the violation of contractual obligations assumed by the debtor, but also according to certain other criteria, such us: procedure to follow in order to obtain actual termination, simplicity of contract termination, etc.

In the following we will briefly present each of these types (degrees) of termination clauses.

The "*first degree termination clause*", the weakest type of such covenant, is the clause by which the parties agree that the creditor (i.e. the damaged party as a result of a breach of contract) has the possibility to request to the court order termination of the contract. Therefore, this type of termination clause is without any addition to the provisions of the Civil Code, but again, repeats, practically, the content of Articles 1019-1021 concerning contract termination. In these circumstances, we believe that the insertion of a "first degree termination clause" in contracts, whether civil or commercial, is useless, being without any practical advantage for the creditor of the unexecuted obligation.

The "*second degree termination clause*" pact is the clause through which the parties establish that, in case the debtor fails to perform its obligations, the creditor of the unfulfilled obligations is entitled to unilaterally terminate the contract. The debtor though can free itself of debt, by performing its obligations until it is summoned in this respect by the creditor. In such a situation, the court requested by the creditor may find that, although the obligation was not performed in due time, however, it was performed before the contract termination was declared by the creditor. In addition, in the case of the second degree termination clause the court may grant, under the final sentence of Article 1021, a grace period, within which the debtor can fulfill its obligations.

It should be emphasized that, in the case of this "second degree termination clause", both the "summoning for delay" institution and the court's possibility to grant debtor a grace period, play an essential role, because if the latter fulfills its obligations in the range of time between the moment its obligations became due and the moment he was summoned for delay, or even before the end of the grace period granted by the judge, the court may dismiss creditor's request for termination of the contract in virtue of the "second degree termination clause".

However, considering that in commercial matters the debtor is any way automatically in delay (by operation of law) at the date its obligations become due, and that according to Article 44 of the Commercial Code the court may not grant a commercial debtor the grace period provided by art. 1021 of the Civil Code, we believe that the insertion of any second degree termination clause in commercial contracts is not an effective measure for the creditor of the unexecuted obligation.

The "*third degree termination clause*" is the clause by which the parties establish that, if one of them can't fulfill its obligations, although it has been summoned for delay, the contract is terminated by law. In this case, unlike the previous ones (degrees I and II) the court is not competent to give any period of grace to the debtor and cannot rule upon the opportunity of actually declaring the contract as terminated.

In what concerns this kind of termination clause, we believe that it is incompatible with commercial contracts. The conclusion is based on the fact that the only specific difference between the third degree termination clause and the fourth degree termination clause (to which we will refer below) is that in the first it is required the debtor's summoning for delay, while in the case of the second one there is no need for any delay summoning, as the termination operates by law when the obligations are not performed. As long as the debtor of a commercial obligation is, by operation of law, in delay at the due date of its obligation, we consider that, in commercial

matters, there is no difference between the third degree termination clause and the fourth degree termination clause.

The "*fourth degree termination clause*" is the contract clause in which the parties stipulate that, in case of default by one party, the contract is terminated by operation of law, without formal notice and without the necessity of any delay summoning procedure or the need to fulfill any other formalities by the damaged party. In other words, when the obligation becomes due and is not performed at its due date, such situation has a direct and automatic result - termination of the contract. The court can only ascertain the termination, and therefore it cannot analyze the opportunity of such termination, but only if the sued debtor has or has not fulfilled the assumed obligations precisely and on time (and consequently if the creditor was entitled to activate this termination clause).

However, the creditor may always choose between activating this fourth degree termination clause and ordering the debtor to perform its obligation. The observation is important, because it is natural to accept that the creditor has the possibility to choose not to terminate the contract, even if he is entitled to, in case he considers more economically efficient for him to continue the contract.

We believe that the fourth degree termination clause is the only species of clause showing a real efficiency in commercial contracts, for the obvious reason that it offers the creditor of the unexecuted or improperly executed obligation the full option between keeping the contract or terminating it immediately and without undergoing cumbersome formalities.

II. Some examples of termination clauses.

In the following we will give four examples of termination clauses, all inserted in commercial contracts that we hit of in our activity, accompanied by short practical considerations to help you avoid or, if necessary, to follow certain formulations of termination clauses inserted in agreements concluded with the occasion of the commercial activity of your company.

Example 1

The parties agree that, upon its entry into force, the contract may be terminated by either party, if the other party does not fulfill its obligations and for the reasons specified in section 10 (force majeure).

Without detailing on the defective nature of this first example of termination clause, we will limit ourselves to underline that this clause lacks any practical use for any of the two parties in the contract.

Therefore, in the presence of such defectuous formulation, the party that wants to terminate the contract for the breach of counterparty's obligations has at hand nothing more than the path provided by Articles 1019-1021 of the Civil Code, without benefiting of any other advantage a termination clause could offer, if properly drafted.

Example 2

Failure to pay on time the performed and received works lead to termination of the contract at the initiative of the contractor, the beneficiary being obliged to pay damages of 1% of their estimated value by the experts at the date of termination.

Similar with the first example, also in case of this termination clause (whose writing is poor also from the linguistic point of view) we found ourselves forced to see the perfect lack of utility of the insertion of a express clause of termination of this type in a construction works contract.

The apparent termination of the contract at the contractor's initiative may not be interpreted and, we believe, will not be interpreted by the courts or arbitration as a termination clause to attract the termination of a work contract upon the simple notification of the contractor, mainly because of the ambiguity of the formulation.

We believe that, in the event of failure to fulfill the obligations by the beneficiary, the only initiative left at contractor's disposal is, without doubt, a legal action in court for terminating this contract (which means this clause does not help enough the contractor).

Example 3

Termination of this Agreement under this Article shall operate on written notification of the Beneficiary, sent with 15 days in advance, no other formality being required for the valid termination of the contract.

Unlike the above examples, in this case we believe that the termination clause is useful to the beneficiary, and, in the hypothesis of breach of contract by the other party, the beneficiary shall be able to determine the automatic termination of the contract by sending a simple notification to this effect to the defaulting party.

Regarding the need to transfer the notification with 15 days prior to the termination date, this should not be confused in any case with the formal notice of delay summoning of the debtor, nor with granting a grace period to the debtor (institutions incompatible with commercial matters), but it has to be understood only as the manifestation of will from beneficiary's part, in the sense of terminating the contract instead of continuing it.

In this example one can best see the option the creditor of the unexecuted obligation has (to which we referred in Section I above) between asking the debtor to fulfill its obligations and terminating the contract.

Example 4

In the event of failure of fulfilling the obligations, the Owner has the right to the "de jure" terminate the contract, without being necessary any notice, subpoena or other legal process, be it judicial or otherwise, except to notify the Tenant in writing about the date of termination (date that the Tenant has breached contractual obligations).

As well as example number 3, this last example too represents a useful termination clause, drawn up properly and which eliminates, from our point of view, any risk on the date on which it operates as a termination, in the event of failure to comply with the contract, by Tenant.

Moreover, for added rigor to the example # 3, it should be noted that in the latter case the termination clause expressly provides that the only effect of the termination notice is to inform the tenant of the date on which the event already occurred, and therefore the date the lease automatically stopped.