

September 2001

## Salient Features of the Principles of European Contract Law: A Comparison with the UCC

Ole Lando

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### Recommended Citation

Ole Lando, *Salient Features of the Principles of European Contract Law: A Comparison with the UCC*, 13 Pace Int'l L. Rev. 339 (2001)

DOI: <https://doi.org/10.58948/2331-3536.1214>

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# SALIENT FEATURES OF THE PRINCIPLES OF EUROPEAN CONTRACT LAW:<sup>1</sup> A COMPARISON WITH THE UCC

Ole Lando

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<sup>1</sup> See COMMISSION ON EUROPEAN CONTRACT LAW, PRINCIPLES OF EUROPEAN CONTRACT LAW, PART I AND II COMBINED AND REVISED (Ole Lando & Hugh Beale eds., 2000) [hereinafter PECL]; See generally, Ole Lando *Eight Principles of European Contract Law*, in MAKING COMMERCIAL LAW, ESSAYS IN HONOUR OF ROY GOODE, 103, (Ross Cranston ed., Oxford 1997); *Some Features of the Law of Contract in the Third Millenium*, 40 SCANDINAVIAN STUDIES IN LAW 342-402 (Stockholm 2000).

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## I. INTRODUCTION

This article compares some of the salient features of the Principles of European Contract Law (PECL) with the corresponding provisions of the American Uniform Commercial Code (UCC).

The Commission on European Contract Law (the Commission) began its work in 1982. The scope of the work is the general principles of contract law. The Commission first prepared rules on performance, non-performance (breach) of contracts and remedies for non-performance. Part 1 of the PECL was published in 1995.<sup>2</sup>

In 1992, the Second Commission on European Contract Law began working on the formation, validity, interpretation and contents of contracts, as well as on the authority of an agent to bind his principal. The Second Commission held its last meeting in May 1996, and subsequently published the PECL Parts I and II in 1999.<sup>3</sup> Like the American Restatements of the Law, the articles are accompanied by comments explaining the operation of the articles as well as notes indicating the sources of the rules and any corresponding rules of the Member States. A third Commission is presently working on various matters including assignment of claims and debts, set-off, and prescription.

The members of the three Commissions are primarily academics, many of whom are practicing lawyers. They are independent and are not representatives of specific political or governmental interests. They all pursue the same objective, i.e., to draft the most appropriate contract rules for Europe.

The main purpose of the PECL is to serve as a first draft of a part of the European Civil Code. However, before the Code is enacted it may serve purposes other than that of a Code. It may have objectives similar to those of the American Restatements

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<sup>2</sup> See COMMISSION ON EUROPEAN CONTRACT LAW, PRINCIPLES OF EUROPEAN CONTRACT LAW, PART 1: PERFORMANCE, NON-PERFORMANCE AND REMEDIES (Ole Lando & Hugh Beale eds., 1995)

<sup>3</sup> See COMMISSION ON EUROPEAN CONTRACT LAW, PRINCIPLES OF EUROPEAN CONTRACT LAW, PARTS I & II (Ole Lando & Hugh Beale eds., 1999).

of the Law,<sup>4</sup> which are non-binding ways of unifying American law. A national court may apply the Restatements when the law is unsettled, or when the court chooses to deviate from the rules of that law. When deciding cases involving contracts, the European Court sometimes needs general principles of contract law common to Member States of the European Union (EU). Furthermore, lawmakers of the European Community have issued and are preparing directives regulating specific contracts.<sup>5</sup> These directives, however, are not well coordinated. For one thing, there is no current legal infrastructure to support such specific measures. The PECL could serve as a matrix to help make the directives more coherent.

Together with the UNIDROIT Principles of International Commercial Contracts<sup>6</sup> (UNIDROIT Principles), the PECL will serve as a guideline for countries wishing to legislate. Several of the former socialist countries in Eastern and Central Europe are consulting these two sets of principles.

Finally, parties to an international contract may wish to have their contract governed by a "neutral" set of rules instead of by national law. Arbitrators deciding commercial disputes between parties from different European Community (EC) countries may apply the PECL or the UNIDROIT Principles. This may also be done when the parties have agreed to have their contract governed by "general principles of law," the *lex mercatoria*, or the like.<sup>7</sup> When drafting international standard form contracts for European or global use, parties may need balanced terms that take account of the interests of both parties. In such circumstances, the parties may refer to the PECL.

The European Parliament favors a Code. Believing that legislation is necessary, the European Parliament passed resolutions in 1989 and again in 1994 requesting the commencement of preparatory work on the drafting of a European Code of Private Law.<sup>8</sup> The preamble to the first resolution, stated that "unification can be carried out in branches of private law which

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<sup>4</sup> See, e.g., RESTATEMENT (SECOND) OF CONTS. (1981).

<sup>5</sup> See LANDO & BEALE, *supra* note 3, at xxiii.

<sup>6</sup> See International Institute for the Unification of Private Law *Principles of International Commercial Contracts* (Rome: UNIDROIT, 1994) [hereinafter UNIDROIT Principles].

<sup>7</sup> See LANDO & BEALE, *supra* note 3, at xxiv.

<sup>8</sup> See *id.* at xxiii.

are highly important for the development of a Single Market, such as contract law.”<sup>9</sup>

On July 11, 2001 the European Commission published a Communication to the Council and the European Parliament on European Contract Law (COM(2001) 398 final) (Communication). Foremost in consideration in the Communication is the position to be adopted in relation to “problems for the functioning of the internal market resulting from the co-existence of different national contract laws.” In the Communication, the European Commission has invited responses from governments, institutions, professional organizations, universities, and experts in the field of European legal studies. The European Commission mentions and invites comments on various options, which the EU could adopt. One is to develop and promote a Restatement that, like the American Restatements of the Law, is “soft law.” Another is the adoption of comprehensive and binding Community legislation in the field of contract law. As of December 2001 the Commission continued to receive answers to the Communication.

## II. FEATURES OF TECHNIQUE AND STYLE

### A. *Simplicity of Language*

The Swiss Code has many of the scholarly qualities of the German Civil Code (BGB) but is not burdened by the scientific character of the BGB. Like the Swiss, the Commission did not attempt completeness; in many topics it gave only an outline. Thus, there are eight articles in the BGB on contracts for the benefits of third parties, two in the Swiss *Obligationenrecht* and one in the PECL.<sup>10</sup>

Accuracy and comprehensibility are important, but sometimes mutually incompatible. Accuracy may burden the text and make it difficult to understand. If, on the other hand, you strive at comprehensibility, the text may lose its accuracy. However, the text should be drafted so that a person who can read and grasp an abstraction will understand the PECL fairly easily. The words of the author of the Swiss Civil Code, *Eugen*

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<sup>9</sup> Resolution of 26 May 1989 OJEC No. C 158/401; Resolution of 6 May 1994 OJEC No. C 205/519.

<sup>10</sup> Compare RESTATEMENT, *supra* note 4.

Huber were in the minds of the Commission when drafting the PECL. According to Huber, the Code "must speak in popular ideas. The man of reason who has thought about his times and their needs should have the feeling as he reads it that the statute speaks to him from the heart. . . . Its provisions must mean something to the educated layman."<sup>11</sup> The parts of the Swiss Civil Code that were prepared by Huber follow the principles that a legal text should have short sentences, short paragraphs and articles with few paragraphs. The Commission tried its best to achieve these goals.

While English was the primary language, one had to consider that the texts were going to be translated into other languages. The Commission learned from the United Nations Convention on Contracts for the International Sale of Goods, 1980 (CISG) the value of using factual language instead of legal terms. Factual language is easier to understand and to translate. The Commission tried to avoid expressions that have a specific legal meaning in the English common law. For instance, it used the term *non-performance* instead of *breach* of contract.

Some statutes contain numerous and large lists of definitions. The UCC is one example. The Commission was of the opinion that, though they may provide accuracy, many definitions make the texts difficult to read and understand and make the rules inflexible. The Commission, therefore tried to avoid many definitions.<sup>12</sup>

### B. *Rules rich in implications*

The French legislator Jean Étienne Marie Portalis, in his *Discours Préliminaire* (1799), said that the articles of the French Civil Code should be written as broad principles that may cover many situations and may comprise new develop-

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<sup>11</sup> HUBER, SCHWEIZERISCHES CIVILGESETZBUCH, ERLÄUTERUNGEN ZUM VORENTWURF 2.12 (1902), *quoting* KONRAD ZWIEGERT & HEIN KÖTZ, INTRODUCTION TO COMPARATIVE LAW, 172 (Oxford 3d ed. 1998).

<sup>12</sup> See, e.g., PECL, *supra* note 1, art. 1:301 includes the meanings of: "act," which includes omissions; "intentional act," which includes reckless acts; "court," which includes arbitral tribunal; "non-performance" (breach) of a contract; "material" matter; and "written" statements; PECL, *supra* note 1, art. 1:302 defines "reasonableness;" PECL, *supra* note 1, art. 2:209(4) defines the expression "general conditions of contract."

ments in society. As Portalis, the Commission realized that times will change and that the rules should give room for an application that takes new developments into consideration. The Commission had confidence in the judges and the arbitrators who are to apply the PECL. PECL Article 1:106 provides for the interpretation and supplementation of the PECL. PECL Article 1:106(1) lays down that "these Principles should be interpreted *and developed* in accordance with their purposes." PECL Article 1:106(2) provides as CISG Article 7(2), that issues which are within the scope of the PECL, but not expressly settled by them are to be settled in accordance with the ideas underlying the PECL as far as possible.

The UCC section 1-102(1) provides that the Act "shall be liberally construed and applied to promote its underlying purposes and policies." Among the underlying purposes and policies listed in UCC section 1-102 (2) are:

- (a) to simplify, clarify and modernize the law governing commercial transactions;
- (b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties;
- (c) To make uniform the law among the various jurisdictions.

The rules governing the interpretation and development of the UCC are not very different from those governing the PECL.

### III. SALIENT FEATURES OF THE PROVISIONS OF THE PECL

#### A. *Freedom of contract and pacta sunt servanda*

##### 1. *You shall keep your contract*

A basic principle in the laws of all countries is to keep your contract. The legislators and courts stick to this with vigor. A contracting party must be able to rely on the contract and exercise the freedom and rights granted to it under the contract. While the *pacta sunt servanda* rule is found in the UNIDROIT Principles, the Commission considered it so obvious that it did not state it in a special rule. It is, however, implied in several articles, including PECL Article 1:102(1), which provides that the "parties are free to enter into a contract and to determine its contents," and PECL Article 6:111, which provides that "a party is bound to fulfill its obligations even if performance becomes more onerous."

Most of the provisions of the PECL are non-mandatory. PECL Article 1:102(1) provides that the parties may determine the contents of their contract "subject to the requirements of good faith and fair dealing, and the mandatory rules established by these Principles." PECL Article 1:102(2) lays down that "the parties may exclude the application of any of the Principles or derogate from or vary their effects, except as otherwise provided by these Principles." UCC section 1-102(3) lays down very similar rules.

## 2. *You shall keep your promise*

There is consistency among the laws that an agreement only becomes a binding contract if the parties have intended to become legally bound. A dinner invitation is morally but not legally binding. Furthermore, the parties must have agreed on terms that are sufficiently definite. This rule seems to be accepted in the laws of the Member States and is stipulated in PECL Article 2:101.<sup>13</sup> There are, however, other problems: Is a party bound by a promise that he intended to be binding but is not supported by consideration? Can a party revoke its offer before it has been accepted?

The Commission found that in business there are promises that should be enforced even though there was no consideration in the English meaning of the word. An example of this is a promise to pay for work or services already completed or agreed upon. The same applies with respect to promises to make a gift or donation. Why should a wealthy American industrialist of Croatian descent not be bound by a promise he made in public to pay one million dollars into a fund for the benefit of wives and children of Croatian soldiers killed in the war between Croatia and Serbia in the late 1990's?

Furthermore, the promisor should in general be bound even though there was no "bargained for" consideration. In fact, the English courts have had problems with their doctrine of consideration and have tempered it by relying on commercial usages,

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<sup>13</sup> Articles in Part 1 cited with a period (.) after the chapter, e.g., Art. 2:117, follow the old numbering, while those with a colon (:, e.g., Art. 2:201) follow the new numbering. The old numbering is changed in Part 2.



estoppel and "invented consideration" to avoid some of the hardships arising under the doctrine.<sup>14</sup>

For these reasons the Commission followed the continental rule that does not require consideration. PECL Article 2:107 provides that "a promise which is intended to be legally binding without acceptance is binding." PECL Article 2:101(1) provides that "a contract is concluded if: (a) the parties intend to be legally bound, and (b) they reach a sufficient agreement *without any further requirement*." This passage disposes of consideration and of formal requirements. It is in accordance with CISG Article 11 and the laws of the United Kingdom, Germany and the Nordic Countries that do not require any form.<sup>15</sup>

As for the second question, whether a party can revoke an offer before it has been accepted, the Commission decided that a party may revoke its offer as long as the offeree has not accepted.<sup>16</sup> However, proposals which the offeror has designated as irrevocable and offers specifying a fixed time for acceptance, create an expectation on the part of the offeree that they will not be revoked.<sup>17</sup> This expectation should be protected. Similarly, if it is "reasonable for the offeree to rely on the offer as being irrevocable and the offeree has acted in reliance on the offer,"<sup>18</sup> it should not be revocable. For instance, if a contractor asks a perspective sub-contractor to submit an offer to be used in the contractor's bid for a construction contract, the sub-contractor should not be permitted to revoke his offer.

PECL Article 2:202(3) takes these considerations into account by providing that the:

revocation of an offer is ineffective if: (a) the offer indicates that it is irrevocable; or (b) states a fixed time for its acceptance; or (c) it

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<sup>14</sup> See ROYSTON GOODE, *COMMERCIAL LAW* 74 (2d ed. 1995) (for promises inducing non-requested reliance and abstract payment undertakings, such as letters of credit and on-demand guarantees); GUENTER TREITEL, *THE LAW OF CONTRACT* 67 (London 10<sup>th</sup> ed., 1999) (for cases involving "invented" consideration); E. ALLAN FARNSWORTH, *CONTRACTS* § 2.2 (Vol. 1, 1990) (for the American theory of consideration).

<sup>15</sup> Compare U.C.C. § 2-201 regarding the formal requirements of the Statute of Frauds.

<sup>16</sup> See PECL, *supra* note 1, art. 2:202(1).

<sup>17</sup> See *id.* art. 2:202(3)(c).

<sup>18</sup> *Id.*

was reasonable for the offeree to rely on the offer as being irrevocable and the offeree has acted in reliance on the offer.

In this respect, PECL Article 2:202 follows CISG Article 16, however, with one important modification. CISG Article 16(2)(a) provides that an offer cannot be revoked "if it indicates, whether by stating a fixed time for its acceptance or otherwise, that it is irrevocable." A reader who is unfamiliar with the background of this provision could believe that specifying the time for the acceptance of an offer would always make it irrevocable; however, this was not the intention of all the delegates who drafted CISG Article 16 in Vienna in 1980. The common law delegates would not agree with the civil law delegates, that an offer would automatically become irrevocable by stating a time for acceptance. Although the outcome of their debate is not very clear, it appears that the question whether an offer is irrevocable depends on the intention of the offeror as it was reasonably understood by the offeree. In contracts between parties having their place of business in a civil law country, any specification of the time for acceptance will generally make the offer irrevocable. On the other hand, contracts between parties from a common law country are generally revocable, if they only specify when the offer lapses and may no longer be accepted. In contracts where an offeree on the Continent receives such an offer from an offeror in a common law country, the offer will be treated as revocable,<sup>19</sup> if it can be proven that the offeree knew or could not have been unaware of the fact that the offeror's intention was to keep the offer revocable.

Since the rule in CISG Article 16(2)(a) may cause uncertainty, it was not adopted by the Commission. Under PECL Article 2:202(3)(b), any specification of the time for the offer's acceptance will make it irrevocable.

Compared with the rules on revocation of an offer in the UCC, PECL Article 2:202(3)(a) resembles that of the firm offer

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<sup>19</sup> See CISG art. 8 on the interpretation of a party's intention; DOCUMENTARY HISTORY OF THE UNIFORM LAW FOR INTERNATIONAL SALES, 280, 307, 374, 499 (Honold ed., 1989)(for a discussion of Art. 16(1)(a) and its genesis); see also E. ALLAN FARNSWORTH in COMMENTARY ON THE INTERNATIONAL SALES LAW 95 (Bianca & Bonell eds., 1987); PETER SCHLECHTRIEM in KOMMENTAR ZUM EINHEITLICHEN KAUFRECHT No. 141 (von Cammerer & Schlechtriem eds., 2d ed. 1995); UNIDROIT Principles, *supra* note 6, at art. 2.4, which contains the same rule as CISG Art. 16(2)(a).

in UCC section 2-205. However, the promise not to revoke does not have to be in writing and separately signed by the offeror. PECL Article 2:202(c) is inspired by the American rules on revocability of subcontractors' bids.<sup>20</sup>

### 3. *You shall render the performance you promised*

Most contracts provide that one party shall pay a sum of money for the goods or services it has purchased and the other party shall deliver the goods or perform the services. If one party fails to perform, can the other request performance?

#### a. *Monetary obligations*

Continental laws allow a creditor to require the performance of a *contractual obligation to pay money*. An action for an agreed sum of money is generally available under the common law, although it is limited in certain respects and may be brought only when the price has been "earned" by performance, see Section 49(1) of the English and Irish Sale of Goods Acts.

Under PECL Article 9:101(1), the creditor can tender his performance to the other party and then claim the price. The rule generally applies even if the buyer later discovers that he does not want performance. In such situations, the buyer of goods and services must pay the price. However, experience gained from England and Scotland seems to indicate that there should be exceptions to the rule. In cases other than the sale of goods, if a buyer repudiates a contract when the supplier has not yet performed and the buyer can show that the latter has no legitimate interest in performing, the supplier's recovery will be subject to its duty to mitigate its loss and its action is confined to one for damages.<sup>21</sup> The underlying consideration is that a debtor should not have to pay for an undesired performance in cases where the creditor can easily make a cover transaction and in other cases where it would be unreasonable to oblige the debtor to pay the price. The latter can occur in construction contracts in which the contract or part of it has not yet been performed, and the owner makes it clear that he does not desire

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<sup>20</sup> See FARNSWORTH, *supra* note 14, at § 3.25.

<sup>21</sup> See *Attica Sea Carriers Corp. v. Ferrostaal Poseidon Bulk Carrier Reederei GmbH*, 1 Lloyd's Rep. 250 (C.A. 1976).

performance and is able to show that the other party has no legitimate interest in performing.

Many Continental systems have no restrictions on claims for payment of the price. However, in Belgian law there are a number of situations where the supplier cannot impose performance upon the buyer and where he can only claim damages (e.g., in construction contracts, *see* Article 1794 of the Belgian Civil Code). Moreover, the supplier cannot insist on performance when this would be an abuse of a right or otherwise contrary to good faith.<sup>22</sup>

Article 61(2) of the Uniform Law of International Sale of Goods (1964) (ULIS) provides that a "seller shall not be entitled to require payment of the price by the buyer if it is in conformity with usage and reasonably possible for the seller to resell the goods." In such case, the contract shall be regarded as terminated and the seller may only claim damages. The CISG, however, has not provided this restriction on the seller's right to perform and claim the price.

Taking past experiences into account, PECL Article 9:101(2) provides that:

in cases where the creditor has not yet performed its obligation and it is clear that the debtor will be unwilling to receive performance, the creditor may nonetheless proceed with its performance and may recover any sum due under the contract unless:

- (a) it could have made a reasonable substitute transaction without significant effort or expense; or
- (b) performance would be unreasonable in the circumstances.

The exceptions under (a) and (b) may be regarded as applications of the principle of proportionality (*see infra* Section III(D)). The rule in PECL 9:101(2)(a) has its counterpart in UCC section 2-709(1)(b).

#### *b. Non-monetary obligations*

With respect to *non-monetary obligations*, the common law makes specific performance a discretionary remedy<sup>23</sup> based on

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<sup>22</sup> *See* Belgian Court of Cassation, Arr. Cass No. 317, RW 1987-88 (January 16, 1986).

<sup>23</sup> *See* GUENTER TREITEL, REMEDIES FOR BREACH OF CONTRACT 43 (New York Oxford University Press 1988); U.C.C. § 2.716.

equity. However, the discretion exercised by the courts is not completely arbitrary but is subject to rules, one of which is that such remedy is only granted if compensation for damages would be inadequate.<sup>24</sup> For this reason, it is granted most frequently in contracts for the sale of land.

The civil law countries generally recognize the aggrieved party's right to specific performance.<sup>25</sup> Under German law it is axiomatic that the aggrieved party has the right to claim performance of the contract and to obtain a judgment ordering the obligor to fulfill it.<sup>26</sup> The right to performance is also emphasized in French law, for instance, in Article 1184(2) of the Civil Code.

The difference between the common law and civil law is important for dogmatic rather than practical reasons. In the civil law countries an aggrieved party will pursue an action for specific performance only if it has a particular interest in performance that cannot be adequately satisfied by compensation.<sup>27</sup> Furthermore, on the Continent as well as in the common law, specific performance is not available whenever performance has become *impossible or unlawful*.<sup>28</sup> Several civil and common law countries also refuse specific performance in cases where it would be deemed *unreasonable*,<sup>29</sup> for instance, if the cost of raising a sunken ship which has been sold would considerably exceed the value of the ship. In most countries on both sides of the Channel, performance is not available in contracts for "*services or work of a personal character*."<sup>30</sup> Similarly, several countries refuse performance if it depends on a *personal relationship*, for example, an agreement to establish or to continue a partnership in which the defaulting partner is to play an active role.<sup>31</sup>

Despite these similar results in practice, the civil and common law lawyers could not reach an agreement on common rules when the CISG was drafted. As a result, CISG Article 46

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<sup>24</sup> See ZWIEGERT and KÖTZ, *supra* note 11, at 480.

<sup>25</sup> See *id.*

<sup>26</sup> See *id.* at 472.

<sup>27</sup> See *id.* at 471.

<sup>28</sup> See *id.* at 472.

<sup>29</sup> See *id.*

<sup>30</sup> See ZWIEGERT and KÖTZ, *supra* note 11, at 482.

<sup>31</sup> See LANDO and BEALE, *supra* note 3, at 161.

gives the buyer the right to require performance, and CISG Article 28 provides that:

if, in accordance with the provisions of this Convention [the CISG] one party is entitled to require performance of any obligation by the other party, the court is not bound to enter a judgment for specific performance unless the court would do so under its own law in respect to similar contracts of sale not governed by this Convention [the CISG].

Thus, CISG Article 28 preserves the discretion exercised by common law courts.

This partition was unnecessary. The civil law countries could have agreed to restrict the right to require specific performance to situations in which such remedy is needed in practice. The common law countries could have conceded to grant the aggrieved party the unconditional right to request specific performance in such situations.<sup>32</sup>

Under PECL Article 9:102(1), the aggrieved party is entitled to request the specific performance of a non-monetary obligation, including the remedying of a defective performance. PECL Article 9:102(2) provides that specific performance cannot be obtained where:

- (a) performance would be unlawful or impossible; or
- (b) performance would cause the debtor unreasonable effort or expense; or
- (c) the performance consists in the provision of services or work of a personal character or depends on a personal relationship; or
- (d) the aggrieved party may reasonably obtain performance from another source.

In regard to the exception under PECL Article 9:102(2)(c), it is explained in the Comments that a judgment ordering the performance of personal services or work would be considered a severe interference with the party's personal freedom. Furthermore, performing such services or work under coercion would often be unsatisfactory for the creditor. Finally, it would be difficult for the court to control the enforcement of such an order.

The exception under PECL Article 9:102(2)(d) is the same as the one provided in PECL Article 9:101(2)(a) and is explained

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<sup>32</sup> See OLE LANDO, COMMENTARY ON THE INTERNATIONAL SALES LAW 237, *in* (Bianca & Bonell, eds., 1987).

by the same reasons. This exception and the one under PECL Article 9:101(2)(b) may be regarded as examples of the application of the principle of proportionality (*see infra* Section (III)(D)).

The rules on the ways and means of enforcing a judgment for performance are left to the national legal system. These rules, however, are different in civil law and common law countries, thus casting doubt on the wisdom of using the common law term *specific performance* in PECL Article 9:102. This term was used in the absence of a better term that would be generally understood by all courts.

## B. *The principle of good faith*

### 1. *The general principle*

A moral principle accepted by every honorable man and woman is that you shall act in accordance with good faith and fair dealing. It is related to *Kant's* categorical imperative: "Your behavior shall be governed by such principles as if you were a legislator in a society of reasonable beings obeying common laws."<sup>33</sup> It is, however, a question whether the moral commandment to act in accordance with good faith and fair dealing should be elevated to a legal principle. The UCC has done so in section 1-203. In Europe the views on whether good faith should have the status of a legal principle differ. This is most graphically illustrated if one compares German and Dutch law with the English and Irish common law. The differences, however, concern the question in general more so than the results in practice.

Section 242 of the BGB provides that the debtor must perform his duty in accordance with good faith, having due regard for commercial practices. Known as the "King" of the BGB, this provision has been used to "moralize" the entire German law.<sup>34</sup> It operates as a "super provision" used to modify other statutory provisions. As such, it has been used to change the rigorous individualism of the original contract law of the BGB and also

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<sup>33</sup> Immanuel Kant, *Metaphysik der Sitten, Einleitung in der Rechtslehre* § C

<sup>34</sup> See ZWIEGERT and KÖTZ, *supra* note 11, at 150.

used as a device to adapt the law to changing social and moral attitudes of society.<sup>35</sup>

Invoking BGB section 242, the German courts have set aside unfair contract terms (*see infra* Section III (B)(2)) and have created a number of obligations which ensure loyal behavior on the part of the parties.<sup>36</sup> Some of these obligations are the duty to cooperate, to take account of the other party's interests, to provide information and to submit accounts. The courts have held that a party's right may be limited or lost if enforcing it would result in the abuse of a right. Clearly, the abuse of a right may take on many shapes, such as the attempt to acquire a right through dishonest behavior, to request a performance that the party would soon have to return, to rely on a behavior that is inconsistent with one's earlier conduct, or to act contrary to the principle of proportionality. For example, when terminating a contract or calling a loan because of a trifling breach by the other party. The principle is open-ended and may impose new obligations.

Some maintain that BGB section 242 should not lead to case law where the courts are allowed to disregard provisions of the contract or rules of law whenever they believe that equity or fairness so demands. However, in view of the many instances in which the courts have applied BGB section 242, one gets the impression of a somewhat undirected case law. Nevertheless, the idea behind this case law has inspired the German legislature and has spread to other Continental countries as well.

Dutch law comes close to German law. Article 6:2 of the Dutch Civil Code of 1992 provides that good faith shall not only supplement the parties' obligations, but may also modify or extinguish them. A rule that would bind the parties by virtue of law, usage or legal act shall not apply if under the circumstances this would be unreasonable by the standards of good faith. Article 6:248 provides a similar rule for contracts.

Article 6:2 of the Dutch Civil Code is an unusual provision. Since the time of Napoleon, the Code has been regarded as infallible. The Dutch Civil Code now permits the courts to derogate from the Code when it would be deemed unreasonable to

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<sup>35</sup> *See id.*

<sup>36</sup> *See id.* at 359.



follow it. This is something that the courts of all countries have done now and then, but have never admitted. Having anticipated Articles 6:2 and 6:248 of the Dutch Civil Code, the Dutch courts began establishing a case law even prior to 1992, which in many respects resembles that of the German courts.<sup>37</sup>

Provisions providing for the application of the principle of good faith in contractual relationships are also found in other countries of the EU. However, it has not permeated the laws of these countries as it has in Germany and the Netherlands. In France it previously played a modest role, but is now considered a principle in expansion.<sup>38</sup> The courts of the Nordic countries have recognized the principle of good faith although it has not been expressed in general terms in the statutes.

In contrast, English common law does not recognize any general obligation to act in accordance with good faith and fair dealing.<sup>39</sup> However, many of the results achieved in the Continental systems by requiring good faith have been reached in English law by more specific rules. For example, a strict moral code has been imposed in fiduciary relationships, and good faith is required in contracts characterized as *uberrimae fidei*. The duty of good faith is also required when the court is asked to grant equitable remedies. There are a growing number of cases where the courts have interpreted the terms of a contract in such a way as to prevent a party from using a clause in circumstances in which it was not intended to be used. New examples of cases where good faith has been invoked are constantly being added to English case law.<sup>40</sup> A foreign observer may ask himself when will the selection of examples be sufficiently large to justify the establishment of a general principle?

On the one hand, a study on *Good Faith in European Contract Law*, shows no great difference between the laws in the

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<sup>37</sup> See Netherlands Civil Code, Book 6, The Law of Obligations, Draft Text and Commentary 73 (Netherlands Ministry of Justice ed., 1977).

<sup>38</sup> See MALAURIE and AYNES, *Droit civil. Les obligations*, No. 622, (7<sup>th</sup> ed., 1997) (Heading : Bonne foi, un principe en expansion); see also TERRÉ, SIMLER and Lequette, *Droit civil. Les Obligations*, No. 414 (6<sup>th</sup> ed. 1996).

<sup>39</sup> See JOSEPH CHITTY, *CHITTY ON CONTRACTS* §§ 1-010, 1-011 (27<sup>th</sup> ed. 1994, Second Cumulative Supp. 1997).

<sup>40</sup> See *id.* § 1-011.

outcome of the cases.<sup>41</sup> The English reports are in line with those of the majority of the Continental countries.<sup>42</sup> On the other hand, the courts of England still claim that they do not recognize any general obligation to act in accordance with good faith and fair dealing. Thus in 1997 the Privy Council refused to order specific performance of a contract for the sale of land to a purchaser who had paid the price ten minutes too late, because time had been made expressly of the essence for the performance of the contract. The court refused to apply equity to this situation, and one of the justices, Lord Hoffmann, expressly rejected the civil law approach to good faith.<sup>43</sup> In the view of the court the predictability of the legal outcome of a case was more important than absolute justice.<sup>44</sup>

PECL Article 1:201 now reads as follows: "Each party must act in accordance with good faith and fair dealing." The formulation is close to that of the UCC section 1-203, which reads "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement." However it covers not only performance, but also the formation, validity and interpretation of contracts.

Practical applications of this rule appear in several specific provisions of the PECL. For instance, an offer is irrevocable if the offeree acted in reliance on the offer; specific performance is denied if performance would cause the obligor unreasonable effort and expense (*see supra* Section III(A)(2)), and a party's duty to perform its obligation may be modified or the party may be released when its obligations have become excessively onerous (*see infra* Section III(E)(2)). The concept, however, is broader

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<sup>41</sup> See *Cambridge Studies in International and Comparative Law. The Common Core of European Private Law*, in GOOD FAITH IN EUROPEAN CONTRACT LAW 653 (Reinhard Zimmermann and Simon Whittaker eds., 2000).

<sup>42</sup> See *id.* at 655. It appears, however, that the Nordic Countries and Ireland are more reluctant to apply good faith than the other European countries. They are small legal jurisdictions. One possible reason for their being out on limb may be that:

where a legal system by its size tends to engender less litigation there are fewer occasions on which courts are presented with facts suitable to test and clarify the application of existing legal rules; and where rules are untested and uncertain, they either remain untempered or are interpreted in a cautious (and therefore often more conservative) way.

<sup>43</sup> See *Union Eagle Ltd. v. Golden Achievement Ltd.*, [1997] 2 All.E.R. 215 at 218.

<sup>44</sup> See *id.*

than any of these specific applications. Its purpose is to enforce community standards of decency, fairness and reasonableness in commercial transactions. It supplements the provisions of the PECL and it may take precedence over other Principles when strict adherence to them would lead to a manifestly unjust result. Thus, even if the non-performance of an obligation were fundamental because strict compliance with the obligation is of essence to the contract under PECL Article 9:103(a), a party would not be permitted to terminate because of a trivial breach of the obligation (*see infra* Section III(D)). Good faith is presumed. The party alleging that the other party has failed to observe good faith and fair dealing must convince the court.

PECL Article 1:201 will sometimes lead to a conflict between law and justice. A law or a contract term that is otherwise valid may, under some circumstances, lead to injustice. As mentioned above, such conflicts may result in undirected case law. However, it is not possible to give general guidelines specifying when the court should let the law prevail. That will depend, *inter alia*, on the extent to which certainty and predictability in contractual relationships would suffer by letting justice get the upper hand. Thus, strict compliance with the terms of a contract may be of the essence when the obligor knows that those responsible for controlling his performance are able to determine whether there is strict compliance, but unable to judge the gravity of a non-compliance.

PECL Article 1:201(2) provides that the rule of good faith and fair dealing is mandatory. The parties may not exclude or limit their duty to act in accordance with good faith and fair dealing. However, some of the other articles, where the principle of good faith and fair dealing is applied, may allow the parties to agree on the terms of their contract. Thus, when making the contract, the parties may agree on who shall bear the risk of certain contingencies, and in such cases they will not be covered by the hardship rule in PECL Article 6:111. Such an agreement, however, is subject to the rules on validity in PECL Article 4:109, in situations when a party takes excessive or grossly unfair advantage of the other party's weak position.

## 2. *Unfair terms not individually negotiated*

The modern mass production of standardized goods and services has also brought about standard contracts.<sup>45</sup> Standardized contract terms make individual negotiation unnecessary and reduce transaction costs. They are often more detailed and more suitable for the contract than the implied terms provided by the law. But standard terms tend to be one sided; one party (the Stipulator) - often the selling enterprise - imposes its terms on the other party (the Adhering Party), thereby letting the Adhering Party carry as many of the risks as possible in the transaction. For instance, the terms may permit the Stipulator to raise the price of his performance prior to delivery, hence after conclusion of the contract. Furthermore, they may require the Adhering Party to remain bound by the contract while the Stipulator is permitted to postpone performance beyond the agreed time, change his performance or even cancel it. There are exemption clauses that exclude the Stipulator's liability in cases of his non-performance or exclude or limit the Adhering Party's right to terminate the contract, as well as clauses that impose severe penalties on the Adhering Party in case of his non-performance. The contract may provide that the Stipulator is not bound by promises and statements made by him or his agents during the negotiations, unless they have been put down in writing and signed by the Stipulator.

As the typically weaker party, the consumer is often unable to understand the written standard terms. For this reason or due to carelessness, he does not even read them, and if he does, he does not care. He believes that the Stipulator will stand by his promise and make a good and conforming tender on time. Even if the consumer might wish to have the terms changed in his favor, he cannot avail against the Stipulator. If he would go to another supplier, the terms would be similar.<sup>46</sup>

For this reason, many laws now provide special protection to consumers in their capacity of an Adhering Party to a standard form contract.<sup>47</sup> In this respect the Germans have led the way. Invoking section 242 of the Civil Code, German courts be-

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<sup>45</sup> See ZWEIGERT and KÖTZ, *supra* note 11, at 353.

<sup>46</sup> See *id.*

<sup>47</sup> See, e.g., SWEDISH LAWS ON CONSUMER SALES (1974); CONSUMER CREDIT TRANSACTIONS (1977); CONSUMERS INSURANCE CONTRACTS (1979).

gan in the 1950s to declare unfair contract clauses unenforceable in consumer contracts and business transactions. In 1976 the validity of standard terms was regulated in the General Conditions of Business Act (German Act), which in many respects consolidated the earlier case law. The German Act section 9 provides that general conditions of business are unenforceable when, contrary to the requirement of good faith, they cause unreasonable detriment to the Adhering Party.

Furthermore, the German Act section 11 contains a catalogue of terms that are to be regarded as invalid *per se* in contracts with consumers (a black list), and the German Act section 10 is another list of terms that the court *may* set aside if they cause unreasonable detriment to the consumer (a gray list).<sup>48</sup> Unlike the general clause in the German Act section 9, the two lists only apply to consumer contracts, not to contracts between business people.<sup>49</sup> However, by virtue of the general clause in the German Act section 9, the courts can also set aside terms listed in the catalogues in the German Act sections 10 and 11 in business contracts, and this has been done to a considerable extent. In such contracts, the black list in the German Act section 11 is only a gray one.<sup>50</sup>

The approach taken by the German Act of 1976 has in several respects been adopted by the EU in the EC Directive on Unfair Terms in Consumer Contracts.<sup>51</sup>

In the chapter on the validity of contracts and contract clauses, PECL Article 4:110 provides rules on unfair contract terms that in several respects follow those of the Directive. Similar to Articles 3(1) and 6(1) of the Directive, PECL Article 4:110(1) provides that:

a party may avoid a term that has not been individually negotiated if, contrary to the requirements of good faith and fair dealing, it causes significant imbalance in the parties' rights and obligations arising under the contract to the detriment of that party, taking into account the nature of the performance to be

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<sup>48</sup> See ZWIEGERT and KÖTZ, *supra* note 11, at 357.

<sup>49</sup> See *id.*

<sup>50</sup> See PALANDT, *BÜRGERLICHES GESETZBUCH*, §§ 9, 10 and 11 notes (55<sup>th</sup> ed. 1996).

<sup>51</sup> Council Directive 93/13, 1993 O.J. (L 95) 29. L 95/29.

rendered under the contract, all the other terms of the contract and the circumstances at the time the contract was concluded.

This general clause may be compared with the rule on unconscionable contracts and contract terms in UCC section 2-302, which applies to sales contracts, and with the similar rule in the *Restatement (Second) of Contracts* section 208 that is meant to cover contracts in general.

The Comment on PECL Article 4:110 refers to a gray list of 17 terms that may be regarded as unfair which have been provided in an Annex of the Directive.

Unlike the Directive, PECL Article 4:110 is not limited to contracts between enterprises and consumers. Hence, terms in contracts concluded between private persons, one of which has used a standard term, and in contracts between powerful enterprises and small businessmen, such as farmers, fishermen, artists, etc. are covered by the provision. All, including the powerful enterprise are protected. Experience shows that such a party may also inadvertently subject itself to unfair terms.

PECL Article 4:110 is mandatory. A party cannot waive its application when the contract is being made. However, it is the responsibility of the disadvantaged party to take the initiative to have the clause set aside or modified.

As in Article 4(2) of the Directive, the court cannot assess whether the main subject matter of the contract or the price is unfair.<sup>52</sup> However, the rules in Chapter 4 of the PECL on “procedural unfairness” may come to the help of a disadvantaged party, notably the rules on mistake, misrepresentation, fraud and on taking excessive or grossly unfair advantage of a party’s weakness. As the case law of several countries shows, the courts tend to find “procedural” unfairness in cases of unequal bargaining power and those where there is a gross disparity between value and price.

Similarly, an individually negotiated contract or a contract term that proves to be unfair is not covered by PECL Article 4:110, but by the rules on “procedural” unfairness mentioned above. If these rules cannot help the disadvantaged party and there is a case of gross unfairness, the general clause on good

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<sup>52</sup> Compare PECL, *supra* note 1, art. 4:110(1) (term allowing a party to raise the price later).

faith and fair dealing in PECL Article 1:201 can be invoked to set aside the unfair contract or term.

C. *Non-performance and remedies: an attempt to establish a universal terminology*

In the CISG, the term *breach of contract* is applied for cases of failure to perform where the obligor carries the risk. This follows from CISG Article 80 which provides that "a party may not rely on a failure of the other party to perform to the extent that such failure was caused by the first party's act or omission."<sup>53</sup> Therefore, when CISG Article 45 provides remedies that the buyer may exercise "if the seller fails to perform any of his obligations under the contract of this Convention [CISG]," it is understood that these remedies cannot be used if the seller's failure to perform was due to contingencies for which the buyer carries the risk. Thus, the remedies are not available if a buyer who purchased goods on FOB conditions does not provide the ship for carriage of the goods.

In the common law of England and the United States, breach presupposes liability for damages. Accordingly, there is no breach unless the aggrieved party would be entitled to claim damages. Under the CISG, non-performance is applicable in cases where the aggrieved party has at least one remedy; this may be damages or another remedy. Most of the remedies specified in CISG Articles 45 et seq. and CISG Articles 61 et seq. mention specific performance, termination (called "avoidance" in the CISG), reduction of the aggrieved party's own performance, and damages. The party's right to withhold its own performance until the other party performs its obligation is found in CISG Article 58. This right is not regarded as a remedy for breach of contract.

The CECL has set up a similar structure and terms for a future European Code. "Breach" is called non-performance, and occurs whenever a party fails to perform any of its obligations under the contract.<sup>54</sup> Non-performance may consist of a defective performance, failure to provide goods which are free from

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<sup>53</sup> See PETER SCHLECHTRIEM, COMMENTARY ON THE UN CONVENTION ON THE INTERNATIONAL SALE OF GOODS art. 80 at 627 (2d ed. 1998).

<sup>54</sup> See Lando and Beale, *supra* note 3, at 120 (on non-performance and remedies).

any rights and claims of a third party, failure to effect a performance in time, which may be a performance that occurs too early, too late or never. It also includes the violation of an accessory duty, such as the duty not to disclose the other party's trade secrets. Where a party is obliged to receive or accept the other party's performance, failure to do so also constitutes non-performance.

The remedies available for non-performance depend on whether the non-performance is excused.<sup>55</sup> In cases where the non-performance is not excused, the aggrieved party is entitled to the right to claim specific performance, to claim damages, to withhold its own performance, to reduce it or to terminate the contract.<sup>56</sup>

If the non-performance is excused, the aggrieved party does not have the right to claim damages or to require specific performance. However, the other remedies mentioned above may be available.<sup>57</sup> Non-performance is excused if the defaulting party "proves that it is due to an impediment beyond its control and that it could not reasonably have been expected to take the impediment into account at the time of the conclusion of the contract, or to have avoided or overcome the impediment or its consequences."<sup>58</sup> In England and the United States failure to perform due to frustration or impracticability<sup>59</sup> is functionally equivalent to what the PECL calls excused non-performance.

#### D. *The principle of proportionality*

The principle of proportionality, which is found in many areas of the law, is a manifestation of the principle of good faith in that it requires a reasonable relationship between an offense and its consequences. For example, if the result of non-performance by a party is not serious, the aggrieved party should not be permitted to apply a drastic remedy.

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<sup>55</sup> See PECL, *supra* note 1, art. 8:101

<sup>56</sup> See *id.* at Chapter 9.

<sup>57</sup> See *id.* art. 8:101(2).

<sup>58</sup> *Id.* art. 8:108(1).

<sup>59</sup> See U.C.C. § 2-165.



### 1. *Termination for fundamental non-performance*

Termination releases the aggrieved party from its contractual obligations. If the contract is terminated before the parties have performed, they will not be required to perform. If one party has delivered property that can be returned, and the other has not, the property will have to be returned and the other will be released from its duty to perform. If both parties have received property, they will have to restore it. Accordingly, the buyer must return the goods and the seller must return the purchase money. In contracts for services, leases and other contracts of duration, termination will generally only release the parties from future performance, whereas performances already rendered will not be affected.

Termination is a remedy with serious consequences for the parties. A party that has incurred costs by tendering or preparing performance will often lose its investment in whole or in part. A party that has relied on goods and services for its enterprise may suffer serious losses if it cannot obtain the property or services, or if it is required to return the property. In international trade, where performance is often rendered over great distances, termination will often hit harder than in domestic trade. For these reasons, many legal systems permit termination only in cases of a fundamental breach by the defaulting party.

As specified in PECL Article 8:103, a non-performance of an obligation is fundamental if:

- (a) strict compliance with the obligation is of essence to the contract;
- (b) the non-performance substantially deprives the aggrieved party of what it was entitled to expect under the contract, unless the other party did not foresee and could not reasonably have foreseen the result; or
- (c) the non-performance is intentional and gives the aggrieved party reason to believe that it cannot rely on the other party's future performance.

PECL Article 9:301(1) provides that a party has the right to terminate the contract if the other party's non-performance is fundamental.

The condition laid down in PECL Article 8:103(a) gives the effect to an agreement between the parties that strict adherence to the terms of the contract is essential. Any deviation from the obligation goes to the root of the contract so as to entitle the other party to be discharged from its obligations under the contract. Thus, if a commercial leasing agreement provides that the object leased *has to* be delivered on a certain date, delivery on that day is of essence to the contract, and any delay will constitute a fundamental non-performance. However, in such cases the principle of good faith in PECL Article 1:201 (see *supra* Section III(B)(1)) can also come into play. If a defect in delivered goods or another non-performance is so trifling that it would be unreasonable for the aggrieved party to terminate the contract, it shall generally not be entitled to do so.

The condition set forth in PECL Article 8:103(b) emphasizes the gravity of the consequences of non-performance for the aggrieved party. It is modeled on CISG Article 25 that contains the definition of fundamental breach. The case law relating to CISG Article 25<sup>60</sup> will be relevant for the interpretation of PECL Article 8:103(b).

PECL Article 8:103(c) applies to an intentional non-performance that gives the aggrieved party reason to believe that it cannot rely on the other party's future performance.

A fundamental non-performance by one of the parties is not the only ground for termination. It is often difficult to determine when a delay in performance has lasted long enough to be deemed a fundamental non-performance. In order to alleviate this uncertainty, PECL Article 8:106(3) provides that in such cases, the aggrieved party may send the defaulting party a notice specifying an additional period of time deemed reasonable for performance. If at the end of that period the defaulting party has not performed its obligations, the aggrieved party may terminate.<sup>61</sup> In its notice, the aggrieved party can specify that if the other party does not perform within the designated period, the contract shall terminate automatically. This *Nachfrist* procedure is also found in CISG Articles 47, 49(1)(b), 63

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<sup>60</sup> See also UNIFORM LAW OF INTERNATIONAL SALE OF GOODS (1964), art. 10 (containing similar text).

<sup>61</sup> See PECL, *supra* note 1, art. 9:301(2).

and 64 (1)(b).<sup>62</sup> This procedure has its origin in German law.<sup>63</sup> The common law and other legal systems do not provide any formal procedure of this kind. However, they will often accept that the aggrieved party, once the date of performance has passed, can "make time of the essence" by serving a notice on the defaulting party to perform within a reasonable time. If at the end of this period, the defaulting party has not performed, the aggrieved party may then terminate the contract.<sup>64</sup> It is left to the court to determine which period of time is reasonable under PECL Article 8:106(3). Regard should be had, *inter alia*, for:

- (a) the period of time originally set for performance; if it was short, the additional time can also be short;
- (b) the aggrieved party's need for quick performance;
- (c) the nature of the performance; a complicated performance may require longer period of time than a simple one; and
- (d) the event that caused the delay, whether it was negligence or *force majeure*.

The rules on termination in the UCC are expressed differently. The perfect tender rule in UCC section 2-601 gives the buyer a right to terminate "if the goods or the tender of delivery fail *in any respect* to conform to the contract." However, as pointed out by *Treitel*, the requirement of seriousness of the breach is re-introduced by a number of other provisions.<sup>65</sup> *White and Summers* claim that the courts' manipulations have so eroded the perfect tender rule that "the law would be little changed if § 2-601 gave the right to reject only upon 'substantial' non-conformity."<sup>66</sup>

## 2. *Other applications of the principle of proportionality*

This principle has been applied in cases relating to the specific performance of monetary and non-monetary obligations.<sup>67</sup> (see *supra* Section III(A)(3)). A mistake may lead to avoidance

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<sup>62</sup> See also UNIFORM LAW OF INTERNATIONAL SALE OF GOODS (1964) arts. 27(2) & 62 (2).

<sup>63</sup> See TREITEL, *supra* note 23, at § 245.

<sup>64</sup> See *United Scientific Holdings Ltd v. Burnley Borough Council* [1978] A.C. 904; *Bunge Corp. v. Tradax* [1981] 1.W.L.R. 77 (Eng.).

<sup>65</sup> See TREITEL, *supra* note 23, at 269.

<sup>66</sup> WHITE & SUMMERS, *UNIFORM COMMERCIAL CODE* 441 (4th ed., 1995).

<sup>67</sup> See PECL, *supra* note 1, arts. 9:101, 9:102.

of the contract only if the mistake is fundamental.<sup>68</sup> "A party who is to perform simultaneously with or after the other party may withhold its performance until the other has tendered performance or has performed. The first party may withhold the whole of its performance or a part of it as may be reasonable under the circumstances."<sup>69</sup> An agreed penalty for non-performance "may be reduced to a reasonable amount where it is grossly excessive in relation to the loss resulting from the non-performance and the other circumstances."<sup>70</sup>

### E. *The principle of rebus sic stantibus*

This principle operates as a modification of the *pacta sunt servanda* principle, (see *supra* Section III(A)(1)). It gives a total or partial relief to a party in case of changed circumstances. In the PECL *rebus sic stantibus* is found in two rules, one on excuse due to an impediment (*vis major*)<sup>71</sup> and the other on changed circumstances (hardship).<sup>72</sup>

#### 1. *Vis major*

In most European countries the principle of *pacta sunt servanda* prevails even in cases where, after its conclusion, the contract has become more onerous for one of the parties. The principle is abandoned only in cases of *vis major*, which for lack of a better term is used here to denote supervening events that make performance impossible or quasi-impossible. In cases of *vis major*, the obligor's non-performance is excused.

The rules are not the same in all legal systems. In civil cases the French doctrine of *force majeure* has imposed strict conditions for excusing the obligor, as has the English doctrine of frustration.<sup>73</sup> Also, in most other legal systems the debtor is relieved of his obligations only if performance has become im-

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<sup>68</sup> See *id.* art. 4:103.

<sup>69</sup> *Id.* art. 9:201(1).

<sup>70</sup> *Id.* art. 9:509.

<sup>71</sup> See *id.* at art. 8:108(1).

<sup>72</sup> See PECL, *supra* note 1, art. 6:111.

<sup>73</sup> See ZWIEGERT and KÖTZ, *supra* note 11, ch. 37 (Fr.); GOODE, *supra* note 14, at 139 (Eng.); TREITEL, *supra* note 14, at 778 (Eng.); RODIÈRE and TALLON, *LES MODIFICATIONS DU CONTRAT AU COURS DE SON EXÉCUTION EN RAISON DE CIRCONSTANCES NOUVELLES*, (Paris 1986) (for a comparative survey of the laws of 8 EC countries).

possible in law or in fact. Some also accept quasi-impossibility where performance, though physically possible, cannot be required because it would be ruinous for most enterprises to perform the contract. Some systems are still more lenient, and relieve the debtor in cases of severe hardship (see *supra* Section III(E)(2)).

Under the *vis major* rule, the debtor is relieved of his obligations if he could not reasonably have been expected to take the impossibility into account at the time of the conclusion of the contract, and if the impossibility occurred outside of the control of the debtor, who is supposed to have control over himself, as well as internal control over his employees, his equipment and inventory.

*Vis major* terminates the contract. There is no room for modification of its terms and no duty for the parties to renegotiate the contract with a view to such modification.

The *vis major* rule is not mandatory. The parties may agree on stricter conditions, for instance, by imposing an absolute obligation on one of the parties, or they may agree on more lenient conditions. This is often done in standard contract terms.

Rules similar to the one mentioned above are found in CISG Article 79<sup>74</sup> and in PECL Article 8:108. They do not use the term impossibility but impediment. The CISG also covers cases where it would be ruinous for most enterprises to perform the contract.

## 2. *Hardship*

In many business circles the strict *pacta sunt servanda* rule is considered too severe. In contracts of duration, such as cooperation agreements, lasting construction contracts, or continuous supply of goods or services, unforeseen contingencies can make performance very onerous for one party, especially in times of depression or unrest. For such contracts, a hardship rule more lenient than the *vis major* rule is needed.

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<sup>74</sup> See Denis Tallon, *Exemption*, in COMMENTARY ON THE INTERNATIONAL SALES LAW, *supra* note 19, at 572 (CISG art. 79); JOHN O. HONNOLD, UNIFORM LAW FOR INTERNATIONAL SALES UNDER THE 1980 UNITED NATIONS CONVENTION 423 (2d ed. 1990); Barry Nicolas, *Force Majeure and Frustration*, 27 AM. J. COMP. L. 231 (1979).

Hardship clauses are inserted into many contract documents. However, the parties often forget to insert them or consider them unnecessary. It has been argued that the party who is then a victim of changed circumstances must bear the consequences of his inadvertence. However, the hardship suffered by a party is often out of proportion compared to its forgetfulness or optimism.

Most of the European laws only grant relief in cases of *vis major* covering impossibility and quasi impossibility, but some legal systems relieve the obligor when performance, though not impossible, has become excessively onerous (Italy: *essessiva onerosità*)<sup>75</sup> or so different that the economic basis on which the contract was concluded has disappeared, (Germany: *Wegfall der Geschäftsgrundlage*).<sup>76</sup> A similar rule is found in Dutch law<sup>77</sup> and in French administrative law.<sup>78</sup> Also, UCC section 2-615 on impracticability will relieve the seller in cases of severe hardship.<sup>79</sup>

The CISG has no separate provision on hardship. It has been argued that CISG Article 79, which deals with exemption in case of impediments, stands somewhere between the very tough French rule on *force majeure* governing civil contracts and the more lenient German rule on *Wegfall der Geschäftsgrundlage*.<sup>80</sup>

As was mentioned above, PECL Article 8:108 contains a rule similar to CISG Article 79. In addition, PECL Article 6:111 contains a provision on hardship. PECL Article 6:111(1) provides that a party is bound to fulfill its obligations even if performance has become more onerous due to an increase in the cost of performance or a reduction in the value of the performance received. This is a warning to those who believe they can get out of a contract merely because it has turned out to be unprofitable.

On the other hand, if performance of the contract has become excessively onerous because of changed circumstances,

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<sup>75</sup> See CODICE CIVIL [C.C.] art. 1467 (Italy).

<sup>76</sup> See ZWIGERT and KÖTZ, *supra* note 11, at 211.

<sup>77</sup> See NIEUW BURGERLIJK WETBOEK [NBW] [Netherlands Civil Code] art. 6:258 (1992).

<sup>78</sup> See BARRY NICHOLAS, *THE FRENCH LAW OF CONTRACT* 208 (2d ed. 1992).

<sup>79</sup> See WHITE & SUMMERS, *supra* note 66, at §§ 3-10.

<sup>80</sup> See HONNOLD, *supra* note 74, at 542 with reference to authors.

PECL Article 6:111(2) requires the parties to enter into negotiations with a view to modifying the contract or terminating it, provided that:

- (a) the change of circumstances occurred after the time of conclusion of the contract,<sup>81</sup>
- (b) the possibility of a change of circumstances was not one which could reasonably have been taken into account at the time of conclusion of the contract, and
- (c) the risk of the change of circumstances is not one which, according to the contract, the party affected should be required to bear.

The hardship rule differs from *vis major* in the following respects:

(a) Performance need "only" be excessively onerous, not impossible. Thus, hardship occurred when an English water company, which in the 1920s had undertaken to deliver water at a fixed price to a hospital for "times ever after," suffered heavy losses in the eighties when the agreed price had become derisory due to inflation.<sup>82</sup> Hardship also occurred when a French gas company, which in 1908 had undertaken to deliver gas to the citizens of Bordeaux for a period of thirty years at a fixed tariff, had to continue to deliver gas in World War I when a severe shortage of coal caused the price of coal used to produce gas to increase four times.<sup>83</sup> These cases would probably also be covered by the rule on impracticability in UCC section 2-615.

(b) The contract is not automatically ended, but may be modified. Being the best judges of their situation, the parties must renegotiate the contract in good faith. They may adapt the contract to the new situation, and, if such adaptation is pointless, end the contract.

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<sup>81</sup> See LANDO and BEALE, *supra* note 3, at 322-323 (The earlier Article 2.117, (now Art. 6:111 (2)(a)) has been changed by the Second Commission to exclude cases where the change of circumstance had already occurred at the time the contract was made. These cases are to be governed by the rules on mistake).

<sup>82</sup> See *Staffordshire Area Health Authority v. South Staffordshire Waterworks Co.* [1978] 1 W.L.R. 1387 (where the Court of Appeal led by Lord Denning through an "interpretation" of the words "for times ever after" in a clause fixing the price of water at 7 pence for a 1000 gallons, which, as he said, could not mean what they said, decided to raise the price).

<sup>83</sup> See NICHOLAS, *supra* note 78, at 208-209 (Gaz de Bordeaux decision, French Conseil d'État [D.P. III] of 30 March 1916 (Sirey 1916.3.17)).

(c) Where the parties do not reach agreement within a reasonable time, the court or the arbitrator may either terminate the contract at a time and on terms determined by the court, or adapt the contract so as to distribute between the parties in a just and equitable manner the losses and gains resulting from the change of circumstances. In either case, the court may award damages to a party for its losses suffered as a result of the other party's refusal to negotiate or for having broken off negotiations in bad faith.<sup>84</sup>

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<sup>84</sup> See PECL, *supra* note 1, art. 6:111(3).