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# The Structure and the Salient Features of the Principles of European Contract Law

This is the first time I address an audience in a Baltic country on the Principles of European Contract Law. I am very pleased and very honoured.

I shall first tell you why the Principles were made and who made them. Then I shall address what they contain, their scope style and technique, and finally some of their salient features.

## 1. Why they were made and who made them

The European Union of today is an economic community. Its purpose is the free flow of goods, persons, services and capital. The Union is based on these four flows. They go by way of contracts. To make the flows go easily it should be made simpler to conclude contracts and to calculate contract risks.

The contract laws of the Union countries differ considerably. Anyone doing business in Europe knows that a foreign law will come to govern some of his contracts with foreign partners. The unknown law of the foreign countries is therefore one of his risks. They are often difficult for him and his local lawyer to understand. They make him feel insecure, and may keep him away from foreign markets in Europe. Thus, the existing variety of contract laws in Europe is a non-tariff barrier to trade.

It is the aim of the Union to do away with restrictions of trade within the Communities, and therefore the differences of law, which restrict this trade, should be abolished.

In the last decades there have been important developments of what may be called the EU contract law. Most significant is the unification of the law of consumer contracts by way of directives. In this way the Union has provided some harmonisation. However, it is only fragmentary. It tends to vary in its level of detail and is often unpredictable in terms of its contents. In addition it is not well co-ordinated, and since the national laws of contract are very different, it causes problems when it is to be adjusted to the various national laws. There is no European law of contract to support these specific measures.

The Principles are intended to become part of a future European Civil Code. They may also serve other purposes. They will apply when the parties have agreed that their contract is to be governed by them. They may be applied when the parties have agreed that their contract is to be governed by the “general principles of law”, the *lex mercatoria* or the like, or when the parties have not chosen any

system or rules of law to govern the contract, see article 1:101 (2). Parties to an international commercial contract often agree that disputes which may arise between them shall be submitted to arbitration. When doing so they also often agree that the contract is to be governed by the *lex mercatoria* i.e. the international customs and usages of international trade, the rules which have been established for this purpose, such as the PECL or the UNIDROIT Principles, and the rules of law which are common to most of the States engaged in international trade or to the States connected with the dispute.

Finally the PECL may help national legislatures that wish to reform their contract law. It is our hope that the Principles may be a source, which the legislators of the Baltic Countries may use.

Since 1982 the Commission on European Contract Law (CECL) has been working to prepare the Principles of European Contract Law (PECL). The CECL has not been appointed by any government or international authority. It has appointed itself. The present 23 Members of the CECL come from all the states of the EU. They have been selected for their independence and have not promoted any governmental or commercial interests. A large majority of the Members have been academics but many of the academics have also been practising lawyers.

## 2. What they contain, their scope, style and technique

The Principles were published in 1999.\*<sup>1</sup> The first chapter contains general rules on the scope and application of the Principles. The next chapters deal with the formation of the contract, that is the agreement between the parties, the authority of an agent to bind his principal, the validity of the contract, which is mostly about defects in the consent such as mistake, fraud, and duress, the interpretation, the contents and the performance of a contract. The final chapters treat breach of contract, which we call non-performance, and the remedies for non-performance such as damages and termination.

The articles drafted are supplied with comments that explain the operation of the articles. In these comments there are illustrations, ultra-short stories which show how the rules will operate in practice. Furthermore, there are notes, which tell of the sources of the rules and state the laws of the Member States.

In 1997 the CECL began to draft additional rules, many of which are common to contracts, torts and unjust enrichment, such as plurality of creditors and debtors, assignment of debts and claims, set-off, and prescription and some other outstanding issues. We finished this part in February this year, and it will be published when edited, probably in 2003.

The Study Group of a European Civil Code, which is established under the leadership of Professor Christian von Bar, is a continuation of this work. The general principles of the law of contracts provided in the PECL will be integrated in what will eventually become a European Civil Code. The Code will deal with obligations, that is contracts, torts, unjust enrichment and *negotiorum gestio*, and with the law of movable property, which includes transfer of title and secured transactions, such as retention of title and mortgages. It will not be a Code in the traditional continental sense. Family law and the law of succession will not be included.

The rules of the Civil Code will not only apply to international trade transactions within Europe; they are to be applied equally to purely domestic transactions.

The PECL, which deal with the general law of obligations, do not make special provision for consumer contracts. On the other hand, the PECL are not confined to commercial relationships but are intended to apply to contracts generally, including contracts between merchants and consumers.

An attempt has been made to draft **short** rules, which are easily understood by the prospective users of the Principles, the practising lawyers and business people. As the authors of CISG we tried to avoid legal concepts and used a factual language, which is easier to translate.

The rules drafted are **broad principles**, not rules that go into details. Broad principles claim a broad interpretation. Like the rules of CISG those of the PECL give room for development and flexibility. Article 1:106 provides that “these Principles should be interpreted **and developed** in accordance with

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<sup>1</sup> O. Lando, H. Beale (eds.). Principles of European Contract Law. Parts I and II. The Hague, 1999, p. xlviii, p. 561.

their purposes”, and that “issues within the scope of the Principles but not expressly settled by them are as far as possible to be settled in accordance with the ideas underlying the Principles.” This is the approach generally adopted by the Continental courts. Flexibility will ensure the continuity and stability of a European civil code.

## 3. The salient features

### 3.1. You shall keep your bargain

This is a basic principle in the laws of all countries. The legislators and courts stick to it with vigour. A contracting party must be able to rely on the contract and exercise the freedom and rights granted to it under the contract. The CECL considered it to be so obvious that it was not stated in a special rule in the PECL. It is, however, implied in several articles, including article 1:102 on freedom of contract and article 6:111 (1) on change of circumstances which provides that a party is bound to fulfil its obligations even if performance becomes more onerous.

### 3.2. 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?

#### 3.2.1. Monetary obligations

A creditor may require performance of a **contractual obligation to pay money**. He 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. Most continental systems have no restrictions on claims for payment of the price. However, experience gained seems to indicate that there should be exceptions to the rule. If the supplier has not yet performed and the buyer repudiates the contract and he can show that the supplier has no legitimate interest in performing, the supplier’s action should be confined to one for damages.\*<sup>2</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 occurs 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 performance and is able to show that the other party has no legitimate interest in performing.\*<sup>3</sup>

Article 9:101 (2) of the PECL 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 section III, 6 below.

#### 3.2.2. Non-monetary obligations

With respect to **non-monetary obligations** the civil law countries generally recognise the aggrieved party’s right to specific performance. Under German law it is axiomatic that the aggrieved party has

<sup>2</sup> See the English case *Attica Sea Carriers Corp. v. Ferrostaal Poseidon Bulk Carrier Reederei GmbH* [1976] 1 Lloyd’s Rep 250 (C.A.).

<sup>3</sup> See Belgian Court of Cassation, 16 Jan. 1986, Arr. Cass No. 317, RW 1987–1988.

the right to claim performance of the contract and to obtain a judgement ordering the obligor to fulfil it. The right to performance is also provided in French law, for instance in article 1184 (2) of the Civil Code.

In contrast the Common Law of the British Isles makes specific performance a discretionary remedy<sup>\*4</sup> based on equity. Generally such remedy is only granted if compensation for damages would be inadequate. For this reason it is administered most frequently in contracts for the sale of land.

The position of the civil law countries is based on dogmatic rather than practical reasons. 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>\*5</sup> Furthermore, on the Continent as well as in the common law, specific performance is not always available. There are, as we shall see, many exceptions from the continental rule.<sup>\*6</sup> In practice the results will often be the same.

Despite the similar results in practice, the civil and common lawyers could not reach agreement on common rules when the Vienna Convention on Contracts for the International Sale of Goods (CISG) was drafted in 1980. Though article 46 of CISG gives the buyer the right to require performance, article 28 provides that, if in accordance with the provisions of the Convention one party is entitled to require the performance of any obligation by the other party, the court is not bound to enter a judgement for specific performance unless the court would do so under its own law in respect of similar contracts of sale not governed by the Convention. Thus article 28 preserves the discretion for the 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. For their part, the common law countries could have conceded to grant the aggrieved party the unconditional right to request specific performance in such situations.<sup>\*7</sup>

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

- (a) performance would be unlawful or impossible; or
- (b) performance would cause the obligor unreasonable effort or expense; or
- (c) performance consists in the performance 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.

Most of these exceptions to the right of specific performance we also find in the civil law countries.

In regard to the exception under (c), it is explained in the Comments that a judgement 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, and finally it would be difficult for the court to control the enforcement of such an order.

The exception under (d) is the same as the one provided in paragraph (2) (a) of article 9:101 and is explained by the same reasons.

The procedural rules on the ways and means of enforcing a judgement 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 article 9:102. The term was used in the absence of a better one that would be generally understood.

### 3.3. You must act in accordance with good faith and fair dealing

A moral principle accepted by every honourable 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 behaviour shall be governed by such principles as if you were a legislator in a society of reasonable beings obeying

<sup>4</sup> See G. Treitel. *The Law of Contract*. 9<sup>th</sup> ed. 1995, p. 918 *ff.*

<sup>5</sup> K. Zweigert, H. Kötz. *An Introduction to Comparative Law*. 3<sup>rd</sup> ed. Oxford, 1998, pp. 470, 479.

<sup>6</sup> See O. Lando, H. Beale (Note 1), p. 399 *ff.*

<sup>7</sup> See O. Lando. *Commentary on the International Sales Law*. Milan: M. Bianca & M. J. Bonell, 1987, p. 237.

common laws.” It is, however, a question whether this moral commandment should be elevated to a legal principle.

In Europe the views vary. This is most graphically illustrated if one compares German law with the English and Irish common law. The differences, however, concern the principle more so than the results in practice.

Section 242 of the German Civil Code provides that the debtor must perform his duty in accordance with good faith and fair dealing, having due regard for commercial practices. Known as the “king” of the Civil Code, this provision has been used to “moralise” the entire German law. In the law of contract, it is applied to the formation and interpretation of contracts and to the granting of relief to a party in cases of changed circumstances. 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 Civil Code and also as a device to adapt the law to the changed social and moral attitudes of society.\*<sup>8</sup>

Authors maintain that section 242 should not allow the courts 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 section 242, one gets the impression that it has produced some decisions that are “undirected, exuberant and variable”.<sup>9</sup>

Dutch law\*<sup>10</sup> comes close to German law and provisions providing for the application of the principle of good faith in contractual relationships are also found in other continental countries. In France where it previously played a modest role, it is now considered a principle in expansion.\*<sup>11</sup> It is recognised by the courts of the Nordic countries, although it has not been expressed in general terms in the statutes.

In contrast the English common law does not recognise any general obligation to act in accordance with good faith and fair dealing. 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, time having 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>12</sup> In the view of the court the predictability of the legal outcome of a case was more important than absolute justice.

However, the English courts often reach the same results as the continental courts by using other rules. For example, a strict moral code has been imposed in fiduciary relationships, such as contracts between solicitor and client and doctor and patient. 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>13</sup>

In the study on Good Faith in European Contract Law edited by Reinhard Zimmermann and Simon Whittaker some 20 reporters of different nationality have assessed the outcome of 30 cases which the editors have chosen. The English reports\*<sup>14</sup> on these cases are in line with those of the majority of the continental countries. Many of the results achieved in the continental systems by requiring good faith have been reached in English law by more specific rules.

Article 1:201 of the PECL adopts the continental approach. It provides: “Each party must act in accordance with good faith and fair dealing.” This provision 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. The concept, however, is broader 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 Principles and it may take precedence

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<sup>8</sup> See K. Zweigert, H. Kötz (Note 5), p. 150.

<sup>9</sup> *Ibid.*

<sup>10</sup> See the Netherlands Civil Code. Book 6. The Law of Obligations. Draft Text and Commentary. Ed. by the Netherlands Ministry of Justice, 1977, p. 73 *ff.*

<sup>11</sup> See Ph. Malaurie, L. Aynes. *Droit civil. Les obligations*. No. 622. 7<sup>th</sup> ed. Paris, 1997. Heading: Bonne foi, un principe en expansion. See also F. Tere, Ph Simler, Y. Lequette. *Droit civil. Les Obligations*. 6<sup>th</sup> ed. Paris, 1996, No. 414 *ff.*

<sup>12</sup> *Union Eagle Ltd v. Golden Achievement Ltd*. [1997] 2. All. E.R. 215 at 218, see also *Arcos Ltd. v. E. A. Ronassen & Son* [1933] AC 270.

<sup>13</sup> See G. Treitel (Note 4), p. 202 *ff.* and Chitty on Contracts, 27<sup>th</sup> ed. (1994), with Second Cumulative Supplement, 1997, § 1011.

<sup>14</sup> *Good Faith in European Contract Law*. Ed. by R. Zimmermann, S. Whittaker. Cambridge Studies in International and Comparative Law. The Common Core of European Private Law. Cambridge, 2000, p. 653.



over other Principles when strict adherence to them would lead to a manifestly unjust result. It may be used to explain some of the rules governed by the principle of proportionality. The principle is open-ended and may impose new obligations.

**Good faith** means honesty and fairness of mind. It is contrary to good faith to exercise a remedy if doing so is of no benefit to the aggrieved party and it is only done to harm the other party. **Fair dealing** means observance of fairness in fact. It covers, for instance, the duty to show due regard for the interests of the other party.

Good faith is presumed. The party alleging that the other party has failed to observe good faith and fair dealing must convince the court.

Article 1:201 will sometimes lead to a conflict between law and justice. It happens when a rule of law or a contract term that is otherwise valid leads to injustice. As mentioned above, such conflicts may result in an 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 essence when the debtor 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.

Article 1:201 (2) provides that the rule in paragraph 1 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 who shall bear the risk of certain contingencies, and in such cases they will not be covered by the hardship rule in article 6:111, see section III, 7 below. Such an agreement, however, is subject to the rules on validity in article 4:109 in situations when a party takes excessive or grossly unfair advantage of the other party's weak position.

### 3.4. Unfair contract terms

The modern mass production of standardised goods and services has brought about standard contracts. Standardised 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 (hereinafter: the stipulator) who is 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 after conclusion of the contract. Exemption clauses may exclude the stipulator's liability in cases of his non-performance or exclude or limit the adhering party's right to terminate the contract. Some clauses impose severe penalties on the adhering party in case of his non-performance. A clause in 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.

The clauses are not always written in simple language, and an adhering party, especially a consumer, is often unable to understand the 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. And even if the consumer might wish to have the terms changed in his favour, he cannot avail against the stipulator. If he would go to another supplier, the terms would be similar. For this reason, many laws now provide special protection to consumers in their capacity of an adhering party to a standard form contract.

#### 3.4.1. EC Directive on unfair terms in consumer contracts

This Directive<sup>15</sup> has now been implemented in all the Member States. Article 2 (b) defines the consumer as "any natural person who in contracts covered by this Directive, is acting for purposes which are outside his trade, business or profession". The consumer buys goods and services for his or her own needs and those of his or her household. Article 3 provides that a contractual term that has not been individually negotiated shall be regarded as unfair — and therefore not binding on the

<sup>15</sup> 93/13/ of 5 April 1993, OJ, L 95/29.

consumer — if, contrary to the requirement of good faith, it causes significant imbalance in the parties' rights and obligations arising under the contract to the detriment of the consumer. In an annex the Directive supplies an indicative and non-exclusive list of 17 terms that may be regarded as unfair (see art. 3 (3)). Article 4 (1) provides that the unfairness of a contract term shall be assessed, taking into account the nature of the goods or services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all the circumstances attending the conclusion of the contract and to all the other terms of the contract or of another contract on which it is dependent.

Under article 4 (2), assessment of the unfair nature of the terms shall relate neither to the definition of the main subject matter of the contract nor to the adequacy of the price and remuneration, on the one hand, as against the services or goods supplied in exchange, on the other hand, in so far as these terms are in plain and intelligible language.

Contracts between private persons and between business enterprises and charities and other non-business organisations fall outside of the scope of the Directive. Nor are contracts between big and powerful enterprises and small and medium-sized traders, artisans, farmers and fishermen covered by the Directive, although their position *vis-à-vis* the enterprise is basically the same as that of the consumer. It has been left to national laws to protect these parties against unfair terms. However, the existing European laws vary considerably in this respect.\*<sup>16</sup>

The Directive is a so-called “minimum-directive”, which means that a Member State is permitted to provide better protection for the consumer than that given by the Directive.

### 3.4.2. PECL

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. Paragraph 1 of article 4:110 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 rendered under the contract, all the other terms of the contract and the circumstances at the time the contract was concluded. The Comments on article 4:110 refer to and bring the list contained in the Annex of the Directive. 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>17</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.

Article 4:110 is not limited to contracts between enterprises and consumers. It covers any terms that have not been individually negotiated. Hence, terms in contracts concluded between private persons, one of which has used a standard term, and in contracts between big enterprises and small businessmen, such as farmers, fishermen, artists, *etc.* may also be set aside. Even the big and powerful enterprise is protected. Experience shows that such a party may also inadvertently subject itself to unfair terms. Similarly, an individually negotiated contract or a contract term that proves to be unfair is not covered by 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 faith and fair dealing in article 1:201 can be invoked to set aside the unfair contract or term.

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

<sup>16</sup> See H. Kötz, A. Flessner. *European Contract Law*. Vol. 1. H. Kötz. Oxford, 1997, p. 124 *ff.*

<sup>17</sup> However, a term allowing a party to raise the price later is covered by article 4:110 (1).

### 3.5. Non-performance and remedies; an attempt to establish a universal terminology

In the EU the rules on breach or non-performance of contract and on remedies for non-performance, and the concepts used vary considerably. We will begin by describing the situations which arise.

Most contracts fix a time for their performance. If this has not been done in the contract, the law will do it. Furthermore, the quality and quantity of the performance is either explicitly provided or implied. If the person obliged to perform — the debtor — has to deliver goods, these must be free from any rights and claims of a third party. The contract may contain other obligations such as the duty not to disclose information received from the other party, or not to engage in certain competitive activities.

If the contract is not performed in accordance with these express or implied terms, the failure to perform may be due to the debtor's fault; or it may be due to other causes where he is not at fault, but for which he nevertheless must bear the risk. The failure to effect due performance may also have been caused by the person receiving performance — the creditor — either by his fault or by other causes for which he bears the risk.

If a party fails to perform duly and is at fault or carries the risk, the aggrieved party may be entitled to certain rights *vis-à-vis* the defaulting party. The aggrieved party may claim damages for its loss suffered as a result of the other party's failure to effect due performance or it may reduce its own performance or withhold it until due performance is effected by the other party. Under certain conditions it may terminate the contract, *i.e.* choose not to perform its obligations and not to claim performance by the other party. Finally, the aggrieved party may have the right to claim specific performance.

It is the "breach of contract" for which the CECL has set up a structure and terms for a future European Code. The system adopted in the Principles of European Contract Law is almost the same as that of CISG.<sup>\*18</sup> Breach is called **non-performance**, and occurs whenever a party fails to perform any of its obligations under the contract.<sup>\*19</sup> Non-performance may consist of a defective performance, failure to provide goods which are free from 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 other duties, 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 or not, see article 8:101 of PECL. In cases where the non-performance is not excused, the aggrieved party is entitled to claim specific performance, to claim damages, to withhold its own performance, to reduce it or to terminate the contract. If the non-performance is excused, the aggrieved party does not have the right to claim damages and to require specific performance. However, the other remedies mentioned above may be available. 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 such impediment into account at the time of the conclusion of the contract to have avoided or overcome the impediment or its consequences (see art. 8:108 (1) of the PECL).

If the non-performance is caused by an act or omission on the part of the creditor he may not resort to any of the remedies. There is no remedy if the creditor is unable to receive performance, even when this is due to an impediment beyond his control.

### 3.6. The principle of proportionality

This principle, which is found in many areas of law, is a manifestation of the principle of good faith in that it requires a reasonable relationship between an offence 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 enforce a drastic remedy.

<sup>18</sup> See P. Schlechtriem. Commentary on the UN Convention on the international sale of goods. Oxford, 1998, article 45, notes 12–17 (U. Huber).

<sup>19</sup> See on non-performance and remedies, O. Lando, H. Beale (Note 1), p. 359 *ff.*



### 3.6.1. Termination for fundamental non-performance

Where a party terminates the contract due to the other party's 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. Termination has, as a rule, only prospective effect, see PECL article 9:305. In contracts for services, leases and other contracts of duration, termination will generally release the parties from future performance, whereas performances already rendered will not be affected. However, 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 the purchase money, see articles 9:306–9:308.

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. For these reasons, many legal systems permit termination only in cases of a fundamental breach by the defaulting party. In international trade where performance is often rendered over great distances, termination will often hit even harder than in the internal trade.

As specified in article 8:103 of the PECL, 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 is 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.

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

The condition laid down in article 8:103 (a) gives effect to an agreement between the parties that strict adherence to the terms of the contract is essential, and that 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, then 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 article 1:201 may 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 article 8:103 (b) emphasises the gravity of the consequences of non-performance for the aggrieved party. It is modelled on article 25 of the CISG that contains the definition of fundamental breach. The case law relating to article 25<sup>\*20</sup> will be relevant for the interpretation of article 8:103 (b).

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 article 8:106 provides that in case of non-performance by the other party 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, see article 9:301 (2). 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.<sup>\*21</sup> If a dispute arises it is for the court to determine which period of time is reasonable. The rule has its origin in German law.<sup>\*22</sup> The other legal systems do not provide any 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”

<sup>20</sup> See also the case law relating to CISG's predecessor, the Uniform Law of International Sale of Goods (1964), article 10 has a similar text.

<sup>21</sup> This *Nachfrist* procedure is also found in articles 47, 49 (1) (b), 63 and 64 (1) (b) of the CISG.

<sup>22</sup> See G. Treitel, *Remedies for Breach of Contract*. Oxford, 1988, § 245 ff.

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>23</sup>

### 3.6.2. Other applications of the principle of proportionality

The principle of proportionality has been applied in cases relating to the specific performance of monetary and non-monetary obligations, see on articles 9:101 and 9:102 above. Under article 4:103 a mistake may lead to avoidance of the contract only if the mistake is fundamental. Article 9:201 (1) provides that a party who is to perform simultaneously with or after the other party may withhold its performance until the other part has tendered his performance or has performed. The party may withhold the whole of his performance or a part of it as may be reasonable. Furthermore, an agreed penalty for non-performance may be reduced to a reasonable amount if it is grossly excessive in relation to the loss resulting from the non-performance in the given circumstances, see article 9:509.

## 3.7. Changed circumstances

Changed circumstances will sometimes modify the *pacta sunt servanda* principle. They will give a total or partial relief to a party. In the PECL they are found in two rules, one on excuse due to an impediment (*vis major*) and the other on hardship.

In French civil law and a number of other legal systems a party can be relieved of his obligations only in situations where performance must be regarded to have become impossible in law or in fact (*vis major*).

However, in many business circles this strict rule is considered too severe. In contracts of duration, such as co-operation agreements, lasting construction contracts, 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. Hardship clauses are inserted in 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.

In addition to rules on *vis major* covering impossibility, some legal systems relieve the obligor when performance, though not impossible, has become excessively onerous (Italy: *essive onerosità*)\*<sup>24</sup> or so different that the economic basis on which the contract was concluded has disappeared (Germany: *Wegfall der Geschäftsgrundlage*).\*<sup>25</sup> A similar rule is found in Dutch law\*<sup>26</sup> and in French administrative law.\*<sup>27</sup>

The Vienna Sales Convention (CISG) has no separate provision on hardship. However, it has been argued that article 79 dealing 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>28</sup> It provides that a party's non-performance is excused if the party proves that the impediment is due to an impediment beyond its control and that it could not reasonably have been expected to take such impediment into account at the time of the conclusion of the contract, or to have avoided or overcome the impediment or its consequences.

Article 8:108 of the PECL provides a rule on impediments similar to article 79 of the CISG. In addition, article 6:111 contains a provision on hardship.

Paragraph 1 of article 6:111 provides that a party is bound to fulfil 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.

<sup>23</sup> See, for England, *United Scientific Holdings Ltd v. Burnley Borough Council* [1978] AC 904 and *Bunge Corp. v. Tradax* [1981] 1 W.L.R. 77.

<sup>24</sup> Italian civil code, article 1467.

<sup>25</sup> See K. Zweigert, H. Kötz (Note 5), pp. 516, 518.

<sup>26</sup> Civil Code of 1992 (NBW) article 6:258.

<sup>27</sup> See B. Nicolas. *The French Law of Contract*. 2<sup>nd</sup> ed. Oxford, 1992, p. 208.

<sup>28</sup> See J. Honnold. *Uniform Law of International Sales*. 2<sup>nd</sup> ed. Deventer, 1991, p. 542 with reference to authors.

However, if performance of the contract has become excessively onerous because of changed circumstances, paragraph 2 of article 6:111 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,
- (b) the change of circumstances was not one which could reasonably have been taken into account at the time of the conclusion of the contract,
- (c) the possibility of a change of circumstances was not one which could reasonably have been taken into account at the time the contract was concluded, and
- (d) the risk of the change of circumstances is not one which 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>\*29</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 30 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>\*30</sup>
- (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.
- (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 loss suffered as a result of the other party’s refusal to negotiate or for having broken off negotiations in bad faith, see article 6:111 (3).

Like the *vis major* rule in article 8:108, article 6:111 is not mandatory. When making their contract, the parties may agree on how the risks are to be distributed.

### 3.8. Some general policies

Finally I shall mention some policies which the CECL have pursued.

The general principles of contract law do not raise many issues of a **constitutional** character, and these issues were not much discussed. However, the PECL upholds the freedom of contract as a fundamental principle, see article 1:102. On the other hand, article 6:109 lays down that even a contract which purports to be everlasting can be ended. No party is bound to the other for an indefinite period of time. The rules on *vices de consentement* (fraud, threat, undue influence, *etc.*) in Chapter 4 on validity show respect for the person’s honour and dignity and so does the prominent role of the good faith principle.

As mentioned under section I the parties may choose the PECL to govern their contract either directly or by implication through agreeing that the contract be governed by the *lex mercatoria*. This means that the **mandatory rules** of the PECL will apply, see article 1:102. If the law otherwise so allows, the choice of the PECL will have the effect that the national mandatory national rules do not apply. However, effect should nevertheless be given to those mandatory rules of national, supranational and international law which according to the rules of private international law are applicable irrespective of the law governing the contract, see PECL article 1:103. A court or an arbitrator will have to give effect to the so-called directly applicable rules of a country having a close connection to the contract. The consumer-protective rules of the EC Directives belong in this category.

<sup>29</sup> See *Staffordshire Area Health Authority v. South Staffordshire Waterworks Co.* [1978] 1 W.L.R. 1387 where inflation had made a price for supply of water agreed in 1929 “for times ever after” derisory, and where the Court of Appeal through an “interpretation” of these words, which according to Lord Denning could not mean what the parties had said, decided to raise the price.

<sup>30</sup> See on the *Gaz de Bordeaux* decision of the French *Conseil d’État* of 30 March 1916 (Sirey 1916, 3.17) B. Nicolas (Note 27), pp. 208, 209.

The PECL leave much in the **hands of the individual party**. A party can unilaterally fix the status and the terms of the contract without waiting for a court to decide the matter. A party may, for instance, unilaterally fix the price and other conditions.\*<sup>31</sup> In case of a *vice de consentement*\*<sup>32</sup> he can declare a contract avoided. If a party commits a fundamental breach of contract the other party can terminate it.\*<sup>33</sup> The party who acts does it subject to the standard of reasonableness and under the subsequent control of the court.

Like most of the legal systems in Europe the CECL agreed that **formalities** are required neither for the formation of a contract nor for the acts by which the parties later modify it or end it, see articles 1:303, 2:101 (1) and 9:303. However, in a clause in a written contract the parties may agree that the writing embodies all the terms of the contract, and that any modification or ending by agreement must be in writing. Such clauses, however, only have a limited effect, see articles 2:105 and 2:106.

The Principles **give the judge powers**, which some European courts have not (yet) got. The court may act as a draftsman, which frames a contract that the parties were unable to make on efficient or reasonable or complete terms. It may set the terms of the contract in case of an unreasonable determination by one party or by a third party, see article 6:105 and 6:106. When a third person who was appointed to fix the price or another term refuses to do so or disappears the court may appoint a third person instead, see article 6:106 (1). When a party can invoke change of circumstances (hardship) as a ground for voiding or modifying the contract and the efforts of the parties to renegotiate the terms of the contract have failed, the court may adapt the contract in order to distribute between the parties in a just manner the losses and gains resulting from the changed circumstance.\*<sup>34</sup>

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<sup>31</sup> Article 6:105.

<sup>32</sup> Article 4:112.

<sup>33</sup> Articles 9:301 and 9:303 (1).

<sup>34</sup> See article 6:111 (3).