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# Should Price Reduction be Recognised as a Separate Contractual Remedy?

## 1. Introduction

Price reduction as a remedy is found in many international instruments and in the legal tradition of diverse countries. For example, it has been regulated in the German Civil Code<sup>\*1</sup> (BGB), the Dutch Civil Code<sup>\*2</sup> (BW), and the Estonian Law of Obligations Act<sup>\*3</sup> (LOA).<sup>\*4</sup> In addition, price reduction belongs to the system of remedies acknowledged in international and EU legislation and model regulations. For instance, price reduction is provided for as a remedy in Directive 1999/44/EC of the European Parliament and of the Council on certain aspects of the sale of consumer goods and associated guarantees<sup>\*5</sup> (i.e., the Consumer Sales Directive), United Nations Convention on Contracts for the International Sale of Goods<sup>\*6</sup> (CISG), Proposal for a Regulation of the European Parliament and of the Council on a Common European Sales Law<sup>\*7</sup> (CESL), and Draft Common Frame of Reference<sup>\*8</sup> (DCFR).

Bearing in mind the recent developments in European contract law that are evident in, for example, the Consumer Sales Directive, the CESL, and the DCFR, one finds price reduction as a remedy to be clearly a topical issue. First of all, the question arises of whether providing for price reduction as a remedy is justified, since, for example, in the Anglo-American legal system it is believed that there is no need for price reduction as a separate remedy—because a set-off between the claim for damages and claim for payment would produce a similar outcome.<sup>\*9</sup> The position has been taken in Dutch law that the effects of price reduction can

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<sup>1</sup> *Bürgerliches Gesetzbuch, Bürgerliches Gesetzbuch in der Fassung der Bekanntmachung vom 2. Januar 2002* (BGBl. I S. 42, 2909; 2003 I S. 738), das zuletzt durch Artikel 7 des Gesetzes vom 19. Oktober 2012 (BGBl. S. 2182) geändert worden ist.

<sup>2</sup> *Burgerlijk Wetboek*, 1.1.1992.

<sup>3</sup> *Võlaõigusseadus*. – RT I 2001, 81, 487; RT I 08.07.2011, 21 (in Estonian).

<sup>4</sup> P. Varul et al. *Võlaõigusseadus III. Kommenteeritud väljaanne* [‘Law of Obligations Act III. Commented Edition’]. Tallinn: Juura 2009, p. 370 (in Estonian).

<sup>5</sup> Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees. – OJ L 171, 7.7.1999, pp. 12–16.

<sup>6</sup> RT II 1993, 21/22, 52.

<sup>7</sup> Proposal for a Regulation of the European Parliament and of the Council on a Common European Sales Law, COM(2011) 635 final. Available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0635:FIN:EN:PDF> (most recently accessed on 10.4.2013).

<sup>8</sup> C. von Bar, E. Clive (eds). *Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (DCFR)*. Full Edition. Munich: Sellier 2009.

<sup>9</sup> J. Basedow, K.J. Hopt, R. Zimmermann, A. Stier (eds). *The Max Planck Encyclopedia of European Private Law*. Oxford: Oxford University Press 2012, p. 1314.

be obtained via partial termination of the contract and that, therefore, there is no need for price reduction as a separate remedy.<sup>\*10</sup> German legal literature too has stated that in some situations the outcome of price reduction and partial termination is similar.<sup>\*11</sup> There may also be some similarities between the outcome of price reduction and withholding of performance. Similarly to national regulations, model rules exhibit differences with respect to price reduction. The Principles of European Contract Law and the DCFR recognise price reduction as a separate remedy, but the drafters of the UNIDROIT Principles of International Commercial Contracts<sup>\*12</sup> (PICC) have decided not to include this remedy therein.

The goal of this article is to answer the question of whether price reduction as regulated in §112 of the LOA, the CISG's Article 50, the CESL's Article 120, Article III-3:101 of the DCFR, and the BGB's §§441 and 638 differs sufficiently from other remedies and whether the function of price reduction, which lies in maintaining the balance of the bargain, can be fulfilled by means of other remedies. For this reason, the preconditions for, and consequences of, price reduction, claim for damages, termination, and withholding of performance are analysed.

## 2. Price reduction and damages claim

### 2.1. Preconditions for price reduction and claiming for damages

Of all remedies, price reduction and compensation for damage in lieu of performance of the obligation are considered the most similar to each other.<sup>\*13</sup> The consequence of use of either of these remedies for the obligee may be the return of a certain amount of money from the obligor or a reduced payment obligation to the obligor.

In terms of the preconditions for applying either remedy upon a breach of a contractual obligation, the two are quite similar. The precondition for both the right to price reduction and filing a contractual claim for damages is that there is a valid contract between the parties and that the obligor has breached his contractual obligation. For compensation for damage, the contract does not have to be a reciprocal contract for pecuniary interest; nor is the precise nature of the breach important. Price reduction, on the other hand, is possible only upon the breach of a reciprocal contract for pecuniary interest by way of defective performance of an obligation.

The third precondition for a claim for damages is the debtor's liability for the breach. Price reduction, however, can be exercised by the obligee whether the obligor is liable for the breach of obligation or not. Accordingly, if the obligor's breach of obligation can be excused, the obligee can use only price reduction as a remedy (LOA, §105; CISG, Art. 79; DCFR, Art. III-3:101 (2); CESL, Art. 106 (4)).

The position taken in Estonian legal theory with respect to sales contracts and contracts for work is that the liability of the seller and the contractor for defective goods or work is absolute, as §218 (1) and §642 (1) of the LOA prescribe that the seller or the contractor, respectively, is liable for the non-conformity of the goods/work, if the non-conformity existed upon the transfer of the risk of accidental loss or damage. It has been suggested that the above-mentioned norms are specific to the general rule under which the obligor is liable if his breach of obligation is not excusable.<sup>\*14</sup> Therefore, even if the breach of obligation is excusable, the seller or contractor shall remain liable for the defects of the goods or work. This, in turn, would mean that the buyer or customer could issue a claim for damages from the seller or contractor even when the breach of obligations is excusable.

The sources used as the basis for drafting of the LOA do not prescribe the seller's or contractor's liability so strictly that the obligee could claim compensation for damage even if the breach of obligation is excusable. In this regard, the seller's liability for defective performance of an obligation is precluded on the basis

<sup>10</sup> *Ibid.*

<sup>11</sup> P. Schlechtriem, M. Schmidt-Kessel. *Schuldrecht. Allgemeiner Teil*. 6. Aufl. Tübingen: Mohr Siebeck 2005, p. 259.

<sup>12</sup> S. Vogenauer, J. Kleinheisterkamp (eds). *Commentary on the UNIDROIT Principles of International Commercial Contracts (PICC)*. Oxford: Oxford University Press 2009.

<sup>13</sup> See also J. Basedow, K.J. Hopt, R. Zimmermann, A. Stier (Note 9), p. 1314.

<sup>14</sup> P. Varul *et al.* *Võlaõigusseadus II. Kommenteeritud väljaanne* ['Law of Obligations Act II. Commented Edition']. Tallinn: Juura 2007, p. 33 (in Estonian); P. Varul *et al.* (see Note 4), p. 61; see also CCSCd 3-2-1-80-08, para. 22; 3-2-1-177-11, para. 11; 3-2-1-5-12, para. 27. Available at <http://www.nc.ee/> (in Estonian).

of Article 79 of the CISG even if the defect existed at the time of transfer of the risk<sup>\*15</sup> if said defect existed in consequence of a circumstance that would be considered to be *force majeure*. The obligor's liability for breach of obligation has also been precluded pursuant to Article III-3:104 of the DCFR and Article 88 of the CESL. The regulation set forth in the BGB is different from that described above, but this law also does not establish the seller's or contractor's liability as absolute.<sup>\*16</sup>

If one were to assume that the excusability of the breach of obligation is of no significance in claiming of compensation for damage when there are defects in the goods or work, it would follow that in contracts of this type, the right to price reduction and the claim for compensation for damage would not differ in terms of liability. This would mean that the advantages of price reduction as a remedy when compared to compensation for damage pursuant to Estonian law would be less than those provided by the CISG, BGB, or DCFR. The fact that price reduction can be applied regardless of excusability, however, has been considered one of the characteristic features of this remedy, especially with regard to sales contracts.<sup>\*17</sup>

The next precondition we consider for the claim for damages is the existence of damage.<sup>\*18</sup> In contrast, the existence of damage need not be proved in the case of price reduction. The same applies for the final condition for the claim for damages—i.e., the causal link between the breach of obligation and the damage incurred.<sup>\*19</sup> Naturally, the existence of a causal link is not necessary for price reduction.

In addition to the material preconditions, there are differences in the enforcement of these two remedies. For a reduction in the price, the obligee must make a declaration, and the contract is amended thereby.<sup>\*20</sup> The right is that of unilaterally altering a legal relationship by means of the declaration (LOA, §112 (2); BGB, §441 (1); CISG, Art. 50). On the other hand, pursuant to the DCFR and CESL it is not completely clear whether it suffices for the declaration to be made in order for the price to be reduced or, instead, a claim must be filed in court. The claim for damages, on the other hand, is a claim and, as such, may be submitted to the obligor directly or through the courts.<sup>\*21</sup> For this reason, the obligee must also account for the possibility of negotiations or a court dispute, which must be settled before he achieves the result he sought when exercising the remedy.<sup>\*22</sup> The situation is similar when the obligee wishes to reduce the price in a case wherein he has already paid the difference from the reduced price. However, if the amount in excess of the reduced price has not been paid yet and thus the claim for repayment of that sum paid in excess does not arise, using price reduction is significantly easier for an obligee than is filing a claim for damages.

One may conclude from the above that price reduction differs significantly in preconditions from the claim for damages. Therefore, price reduction cannot be considered a more specific case of claim for damages even if the outcomes with these two remedies are sometimes similar.

## 2.2. Enforcement of price reduction and damages claim

The position expressed in legal theory is that price reduction and compensation for damage are separate remedies as the purpose achieved by using each of them is different.<sup>\*23</sup> The purpose of price reduction is to maintain the balance of the contracting parties' obligations in a situation wherein the obligee has accepted the defective performance of an obligation by the obligor.<sup>\*24</sup> The purpose of compensation for contractual

<sup>15</sup> P. Schlechtriem, I. Schwenzer. *Commentary on the UN Convention on the International Sale of Goods (CISG)*. 23rd edition. Oxford: Oxford University Press 2010, p. 597.

<sup>16</sup> R. Zimmermann. *Breach of Contract and Remedies under the New German Law of Obligations*. Roma: Centro di studi e ricerche di diritto comparato e straniero 2002, p. 2.

<sup>17</sup> J.O. Honnold. *Uniform Law for International Sales under the 1980 United Nations Convention*. Fourth edition. The Hague: Kluwer Law International 2009, p. 337.

<sup>18</sup> P. Varul et al. *Võlaõiguseadus I. Kommenteeritud väljaanne* [Law of Obligations Act I. Commented Edition]. Tallinn: Juura 2006, p. 393 (in Estonian).

<sup>19</sup> *Ibid.*

<sup>20</sup> CCSCd 3-2-1-13-04, para. 26; 3-2-1-156-11, para. 21; 3-2-1-17-12, para. 12. Available at <http://www.nc.ee/> (in Estonian).

<sup>21</sup> P. Varul et al. (see Note 18), p. 318; T. Bachmann. *Die elektive Konkurrenz*. Berlin: Duncker & Humblot 2010, p. 294.

<sup>22</sup> C.M. Bianca, M.J. Bonell. *Commentary on the International Sales Law: The 1980 Vienna Sales Convention*. Milan: Giuffrè 1987, p. 373.

<sup>23</sup> *Ibid.*, p. 372.

<sup>24</sup> C. Twigg-Flesner. The E.C. Directive on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees – all talk and no do? – *The Journal of Current Legal Issues* 2000/2. Available at <http://webjcli.ncl.ac.uk/2000/issue2/flesner2.html> (most recently accessed on 10.4.2013); B.S. Markesinis, H. Unberath, A. Johnston. *The German Law of Contract:*

damage, on the other hand, is to place the aggrieved person in a situation as near as possible to that in which the person would have been if the circumstances that are the basis for the compensation obligation had not occurred.<sup>\*25</sup> Through this, the aggrieved person's performance interest is deemed protected.<sup>\*26</sup> On the other hand, the regulation of compensation for damage is not used to protect the obligee's interests with regard to the proportion of the ratio between the price and the value of performance of the obligation.<sup>\*27</sup>

Since these two remedies have different purposes, the methods for determining the amount to be saved or returned as a result of their use vary too. The reduced price is commonly found by multiplying the price agreed upon between the parties by the value of the defective performance and dividing the result of this multiplication by the value of conforming performance.<sup>\*28</sup> To determine the amount of compensation for damage upon the performance of an obligation being of lesser value than that agreed upon, one takes the difference between the values of conforming performance and defective performance in order to obtain the amount of damage.<sup>\*29</sup> In the case of defective performance of a reciprocal contract for pecuniary interest, one contracting party shall have a payment obligation and simultaneously a claim of compensation for damage against the other party to the contract. This creates a situation wherein the person described has the right to offset his claim against the obligor arising from the compensation for damage against the claim arising from his own obligation of payment. Therefore, to determine the amount to be paid back to or saved by the obligee, one must subtract the difference between the values of conforming and defective performance from the price agreed upon between the parties.<sup>\*30</sup>

Although the reduced price and the amount of compensation for damage are found through different methods, there are often cases wherein the use of both of these remedies would yield the same result.<sup>\*31</sup> However, offsetting the claim for damages against the other party's claim for payment does not always lead to the same results as the method used for reducing the price. In the case of proportional price reduction, comparison is made between the proportion of the ratio of the value of conforming to defective performance and the original price.<sup>\*32</sup> In determination of the amount of compensation for damage incurred on account of the lower value of the performance of the obligation, however, the price agreed upon between the parties bears no significance.<sup>\*33</sup> Therefore, one must conclude that price reduction and the claim for damages are two clearly different remedies and that price reduction cannot be considered a specific type of damages.

### 3. Price reduction and termination of, or withdrawal from, the contract

#### 3.1. Preconditions for price reduction and termination of and withdrawal from contract

Although, in general, price reduction and compensation for damage have been considered the most similar remedies, there are also similarities between price reduction and termination. The outcomes of price reduction and partial termination of the contract may turn out to be especially similar. For example, the position taken with regard to Dutch law is that, even though price reduction has not been stipulated as a remedy at

*A comparative Treatise*. Second edition. Oxford: Hart Publishing 2006, p. 510; CCSCd 3-2-1-131-05; 3-2-1-156-11, para. 23; 3-2-1-17-12, para. 12.

<sup>25</sup> CCSCd 3-2-1-106-03, para. 14; 3-2-1-32-12, para. 11; P. Varul *et al.* (see Note 18), p. 439.

<sup>26</sup> G.H. Treitel. *Remedies for Breach of Contract: A Comparative Account*. Oxford: Oxford University Press 1988, p. 82.

<sup>27</sup> M. Hirner. *Der Rechtsbehelf der Minderung nach dem UN-Kaufrecht (CISG)*. Frankfurt/M. etc: Peter Lang 2000, p. 329.

<sup>28</sup> J. Basedow, K.J. Hopt, R. Zimmermann, A. Stier (see Note 9), p. 1315; H. Sivesand. *The Buyer's Remedies for Non-Conforming Goods: Should There Be a Free Choice or Are Restrictions Necessary?* Munich: European Law Publishers 2005, p. 66. For further discussion, see P. Kalamees. *Hinna alandamine õiguskaitsevahendite süsteemis* ['Price Reduction in the System of Remedies']. Tartu: Tartu Ülikooli Kirjastus 2013, p. 18 (in Estonian).

<sup>29</sup> P. Varul *et al.* (see Note 18), p. 443; CCSCd 3-2-1-32-12, para. 11; S. Kröll, L. Mistelis, P.P. Viscasillas. *UN-Convention on the International Sales of Goods (CISG)*. Munich: C.H. Beck 2011, Article 50, Comment 36.

<sup>30</sup> G.H. Treitel (see Note 26), p. 105; P. Varul *et al.* (see Note 18), p. 443.

<sup>31</sup> P. Kalamees (see Note 28), p. 91.

<sup>32</sup> J. Basedow, K.J. Hopt, R. Zimmermann, A. Stier (see Note 9), p. 1315.

<sup>33</sup> G.H. Treitel (see Note 26), p. 105; C. von Bar, E. Clive (see Note 8), p. 924; P. Schlechtriem, I. Schwenzer (see Note 15), p. 1004.

all there, price reduction is still possible through partial termination of the contract (BW, Art. 6:270).<sup>\*34</sup> In addition to outcomes, price reduction and termination of the contract have other features in common.

The precondition for exercise of either the right of price reduction or termination of the contract is that there is a valid contract between the parties and that the obligor has breached contractual obligation. Since price reduction is possible only in cases of reciprocal contracts<sup>\*35</sup> and cases of defective performance of an obligation, the possibilities for termination of the contract are somewhat broader in this regard. However, further similarities between price reduction and termination of the contract can be found only if the obligor breaches an obligation arising from a reciprocal contract by performing the obligation defectively, because price reduction is possible only with reciprocal contracts<sup>\*36</sup> and in cases of defective performance of an obligation.

The consequences of price reduction and termination of the contract may be similar upon partial termination of the contract (LOA, §116 (3); BGB, §323 (5); BW, Art. 6:270; CISG, Art. 51; DCFR, Art. III-3:506; CESL, Art. 117). Generally, under those rules, a contracting party may partially terminate the contract only if the obligations arising from that contract are to be performed in parts and the fundamental breach of contract has occurred with regard to only some obligation or part of an obligation.<sup>\*37</sup> Therefore, normally the similarity between partial termination of the contract and price reduction can only be discussed when an obligor breaches an obligation that can be divided into parts.

The next condition for termination of the contract is that the breach of obligation is fundamental (§116 (1) of the LOA; CISG, Art. 49 (1a); DCFR, Art. III-3:502; CESL, Art. 114). For one to be able to use the right of price reduction, the existence of a fundamental breach of contract is not required.

Similarly to price reduction, termination as a remedy is a right to alter legal relations unilaterally.<sup>\*38</sup> This means that both price reduction and termination take place by way of the corresponding declaration to the other party to the contract.<sup>\*39</sup>

In principle, all of the above is applicable also to withdrawal from the contract.

From the foregoing discussion, one can conclude that the preconditions for price reduction and termination of the contract or extraordinary withdrawal from the contract as remedies are somewhat similar. In their preconditions, price reduction and termination of, or withdrawal from, the contract are actually more similar than compensation for damage and price reduction are.

### 3.2. Results of price reduction and termination of, and withdrawal from, a contract

As a result of price reduction, the obligee does not have to pay the obligor the price agreed upon in the contract and instead pays a reduced price. If already having paid the other contracting party the price agreed upon in the contract and only after the price having been reduced, the obligee has the right to make a claim for the return of the amount in excess of the reduced price (LOA, §112 (3); BGB, §441 (4); DCFR, Art. III-3:601 (2); CESL, Art. 120 (2)). As a result of termination, the rights and obligation arising from the contract are terminated *ex nunc* and a so-called obligation of contractual restitution is created.<sup>\*40</sup> Thus, the outcome of both price reduction and termination is transformation of the obligation and in certain cases the creation of a restitution obligation. Therefore, the content of the restitution obligations created through use of these two remedies must be compared.

The outcomes reached through price reduction and that of termination of the contract are mostly similar if the obligee is entitled to reduce the price to zero.<sup>\*41</sup> If the value of defective performance is equal to

<sup>34</sup> J. Basedow, K.J. Hopt, R. Zimmermann, A. Stier (see Note 9), p. 1314.

<sup>35</sup> P. Varul *et al.* (see Note 18), p. 365.

<sup>36</sup> *Ibid.*

<sup>37</sup> Only the regulation provided in the BW's Article 6:265 is different.

<sup>38</sup> B.S. Markesinis, H. Unberath, A. Johnston (see Note 24), p. 420; P. Varul *et al.* (see Note 18), p. 315.

<sup>39</sup> On termination, see H.G. Bamberger, H. Roth. *Beck'scher Online-Kommentar BGB. Stand 1.11.2012*. 25th edition, §323, column 31. Available at <http://beck-online.beck.de/Default.aspx?typ=reference&y=400&w=BeckOK&name=ZivR> (most recently accessed on 10.4.2013).

<sup>40</sup> I. Kull, M. Käerdi, V. Kõve. *Võlaõigus I. Üldosa* [‘Law of Obligations Act I. General Part’]. Tallinn: Juura 2004, p. 298 (in Estonian); CCSCd 3-2-1-107-08, para. 9; 3-2-1-57-11, para. 31; 3-2-1-104-11, para. 25.

<sup>41</sup> P. Schlechtriem, I. Schwenzer (see Note 15), p. 777.

zero, the amount of the reduced price too will be zero. If the obligee has not paid the price, the contract is deemed amended after the declaration of price reduction is made and the obligee is not obliged to pay the price agreed upon in the contract.<sup>42</sup> On the other hand, if the obligee has already paid the amount in excess of the reduced price, he can reclaim the sum paid in excess pursuant to the corresponding provisions pertaining to termination (LOA, §112 (3); BGB, §441 (4)). Unlike in the case of termination, there is no reciprocity in the case of price reduction, and, consequently, under Estonian law, the obligee does not have to surrender what he received simultaneously with the return of the money (LOA, §112 (3)).<sup>43</sup> That is, the precondition for price reduction is that the obligee has accepted the defective performance 'as-is'.

The commentators on the BGB have taken different positions on this issue. One position is that if the price is reduced to zero since the performance of the obligation has no value whatsoever, in the case of a sales contract the valueless object must be returned to the seller, as otherwise there would be an unacceptable conflict with the regulation of termination.<sup>44</sup> In the opinion of the authors of the present article, it is not necessary to return the completely valueless performance of an obligation upon price reduction. If the performance of the obligation has become completely valueless, the other contracting party does not have a justified interest in its return, and the obligee would only incur additional expenses in relation to such a return.

An obligee may obtain an outcome that is similar in essence to price reduction by exercising his right of termination. In a parallel to the consequences of price reduction when the price has been reduced to zero and the price has been paid, the obligee shall have a claim against the obligor for the return of the amount paid and for the surrender of fruit and other profit obtained. Unlike upon price reduction, however, the obligee must also return what was given to him on the basis of the contract. Therefore, one cannot conclude that reducing the price to zero is a certain type of termination.

Another situation wherein price reduction and termination of the contract have notably similar features is when it is possible to terminate the contract partially.<sup>45</sup> To illustrate the similarity of the remedies mentioned, the authors at this point provide the following example involving a sales contract. Imagine that a seller has promised to deliver six coffee machines to the buyer with the parties having agreed that the seller shall deliver the machines to the buyer in two separate deliveries (three coffee machines in each). The buyer undertakes to pay 6,000 EUR in total for the machines (making the price of one machine 1,000 EUR). The price agreed upon corresponds to the market value of similar coffee machines.

The first batch of coffee machines is in complete conformity with the terms and conditions agreed upon in the contract. The coffee machines in the second batch, however, have such extensive defects that it is impossible to use them and, on account of the defects, they have no market value. Neither can they be repaired. This would probably constitute a fundamental breach of contract. Consequently, the buyer can terminate the contract only with regard to the coffee machines in the second batch. The restitution obligation created as a result of such termination does not cover all of the parties' contractual obligations. Specifically, the buyer shall have the right to reclaim the amount he paid for the three coffee machines in the second batch, 3,000 EUR.

The buyer would reach the same outcome if deciding to reduce the price paid instead of terminating the contract. The amount of the reduced price in this case would be 3,000 EUR ( $3,000 \times 6,000 / 6,000 = 3,000$ ). Therefore, it makes no difference for the buyer in the example case which remedy he decides to use – the amount returned to him is exactly the same.

The differences between the outcomes of price reduction and partial termination of the contract, however, become evident when, even though a party has fundamentally breached obligations divided into parts, the performance of the obligation has not been rendered completely valueless as a result. In the case described, one could imagine a situation wherein, defects notwithstanding, a market value for the machines can be found (even if only as spare parts for other machines). Let us presume that the value of the coffee machines with the defects that constitute a fundamental breach of contract is 300 EUR. The remaining market value of the machines does not affect the consequences of partial termination of the contract, but the machines are to be returned to the seller on account of the restitution obligation created between the

<sup>42</sup> H.G. Bamberger, H. Roth (see Note 39), §441, column 14.

<sup>43</sup> P. Varul *et al.* (see Note 18), p. 375.

<sup>44</sup> H.G. Bamberger, H. Roth (see Note 39), §441, column 26.

<sup>45</sup> H. Kötz. *Vertragsrecht*. Tübingen: Mohr Siebeck 2009, p. 389; E. Bergstein, A. Miller. The remedy of price reduction. – *American Journal of Comparative Law* 1979 (27), p. 275.

parties. Contrastingly, the situation upon price reduction would be significantly different: the amount of the reduced price would be 3,300 EUR (since  $3,300 \times 6,000 / 6,000 = 3,300$ ). This means that, after the price reduction, the buyer can reclaim 2,700 EUR (or  $6,000 - 3,300$ ) from the seller. The amount received upon partial termination would be 3,000 EUR. The example provided above leads to the conclusion that, regardless of certain similarities between the outcomes of price reduction and partial termination of the contract, it cannot be said that these two remedies are essentially the same.<sup>46</sup>

Similarly to termination and price reduction, withdrawal from the contract is a right to alter legal relations unilaterally. Unlike in the case of the right of termination, however, restitution does not take place.<sup>47</sup> Upon withdrawal, both contracting parties are released from any future performance of principal contractual obligations. Still, the rights and obligations already created under the contract shall remain valid. The consequences of price reduction in cases of continuous contracts are generally directed at the transformation of obligations that have already become due, and obligations created in the future should not be affected by the price reduction. This means that the consequences of price reduction and withdrawal from the contract are not substantively similar.

As an exception, it is possible under Estonian law (§112 (4) of the LOA) to reduce the price prior to the obligation becoming due. Price reduction can primarily be considered when it is certain that the obligation will be performed defectively.<sup>48</sup> Then, price reduction also has an impact on the future performance of contractual obligations. The distinction between these two remedies is clear if there is no wish to reduce the price to zero: as mentioned before, all parties' future obligations are terminated upon withdrawal from the contract, while in the case of price reduction, they remain in place in their post-amendment form. On the other hand, the situation may be more complicated if the obligee wishes to reduce the price to zero prior to the obligation becoming due, as the obligee will come to the same general outcome by means of either of these remedies. Still, these cases are probably quite rare in practice. It is rather difficult to imagine a situation wherein, for example, in the case of a lease contract it is clear in advance that the lessor can only perform his obligations with such extensive defects that they would render the performance valueless in full but the lessee still does not wish to withdraw from the contract. In theory, however, this is still possible. In this case, price reduction and withdrawal from the contract lead to exactly the same outcome with regard to payment of the price. Still, reducing the price to zero is an exception, so one cannot conclude from it that price reduction and withdrawal from the contract are the same remedy in essence. Additionally, in the case of price reduction in continuous contracts prior to the obligation becoming due, some accessory contractual obligations that would be terminated upon withdrawal from the contract may remain in force.

## 4. Price reduction and withholding performance

In addition to similarities with compensation for damage and termination of, or withdrawal from, the contract, price reduction possesses certain features similar to those of withholding performance of an obligation.<sup>49</sup> Comparison can only be drawn with the right to withhold performance in the case of a reciprocal contract (LOA, §111; BGB, §322; DCFR, Art. III-3:401, CESL, Art. 113). In the case of a reciprocal contract, one party may withhold performance until the other party has performed his obligation. The preconditions for price reduction and withholding performance thus are quite similar. Most importantly, both remedies can only be exercised with reciprocal contracts and when the obligation is due but yet to be performed whereas price reduction can only be considered upon defective performance of an obligation.

The next precondition for withholding of performance is that the reciprocal obligations arising from the contract must be performed simultaneously or that the party wishing to withhold performance has to perform his obligation after the other party fulfils his own.<sup>50</sup> If the party wanting to withhold performance of his obligation owes the other party a certain sum of money, this means that he can only withhold

<sup>46</sup> See also M. Hirner (Note 27).

<sup>47</sup> P. Varul *et al.* (see Note 18), p. 651.

<sup>48</sup> *Ibid.*, p. 374.

<sup>49</sup> F. Faust. Remedies for breach of contract in the DCFR. – G. Wagner (ed.). *The Common Frame of Reference: A View from Law and Economics*. Munich: Sellier 2009, p. 21.

<sup>50</sup> P. Varul *et al.* (see Note 18), p. 365.

performance as long as he has not paid the money. Price reduction, on the other hand, is possible also after the obligee has performed his payment obligation when he wishes to reclaim the amount paid in excess.

The primary difference in the preconditions for these two remedies is the fact that, in order to reduce the price, the obligee must have accepted the obligor's defective performance. This situation also reflects the fundamental difference between these two remedies—namely, that price reduction is a right of unilaterally altering legal relations that is directed at transforming the contract between the parties as if it had been concluded with defective performance in mind to start with. Withholding performance is essentially an objection<sup>\*51</sup> that an obligee may enforce in order to bring about performance of the contract as agreed (i.e., a coercive feature).<sup>\*52</sup> Minimising the obligee's damages could be considered the second purpose of the right to withhold performance.<sup>\*53</sup> Evidently, the purposes of these two remedies differ significantly. Therefore, one can conclude that, regardless of some similarities in the preconditions for the two remedies, they are still two separate remedies, serving vastly different purposes.

However, there are individual situations wherein price reduction and withholding performance would have quite similar consequences for the obligee. This is possible if, for example, the obligee withholds his performance whilst the obligor does not wish to rectify his defective performance at all. Still, even in this situation it is rather unlikely that the application of either of these remedies would yield the exact same outcome as the use of the other. Whereas the amount the obligee may refuse to pay or may reclaim upon price reduction depends on the proportions of the values of performance of the obligation, the situation is not the same upon withholding of performance. The obligee has been granted the right to withhold performance primarily in view of situations wherein he may refuse to perform his obligation in full. The right to withhold performance is limited when its exercise would not be reasonable in the given circumstances (LOA, §111 (3); BGB, §320 (2); DCFR, Art. III-3:401 (4); CESL, Art. 113 (3)), primarily when the other party to the contract has performed most of the obligation.<sup>\*54</sup> Referring to this provision of the LOA, the Estonian Supreme Court has stated that upon defective performance, a party cannot withhold performance in the full amount if the defects in the performance of the obligation are minor in relation to the total amount to be paid.<sup>\*55</sup> In this case, the obligee may withhold payment only in the amount that would likely be required for elimination of the defects and for compensation for expenses and other damage related thereto. Upon price reduction, one does not have to take these values into account. Accordingly, the outcomes of price reduction and withholding of performance generally do not match.

Once again, the exception to this is the situation wherein the obligation has been performed with such extensive defects that the value of the defective performance is equal to zero. In this case, the defects are probably sufficiently fundamental to justify withholding performance in full. In this situation, the price upon price reduction would be zero and the obligee would not be obligated to pay the obligor the remuneration agreed upon. If the obligor does not perform his obligation, withholding performance, too, is essentially permanent.

Still, if the obligor wishes to conclusively refuse payment for performance of an obligation, under Estonian law he must terminate the contract or reduce the price in the relevant extent. The Estonian Supreme Court has pointed out that the right to withhold performance does not terminate the obligation; it is essentially a temporary objection.<sup>\*56</sup> Therefore, the right to withhold performance does not, in general, enable one to conclusively refuse payment of the remuneration. The latter reasoning leads to the conclusion that price reduction and withholding performance may have a similar impact on the obligation if the other party to the contract does not wish to cure his defective performance at all. Still, the two remedies are essentially different.

<sup>51</sup> *Ibid.*

<sup>52</sup> C. von Bar, E. Clive (see Note 8), p. 843.

<sup>53</sup> CCSCd 3-2-1-80-08, para. 34; C. von Bar, E. Clive (see Note 8), p. 843.

<sup>54</sup> See also R. Feltkamp, F. Vanbossele. The optional European sales law: Better buyer's remedies for seller's non-performance in sales of goods? – ERPL 2011 (6), p. 898.

<sup>55</sup> CCSCd 3-2-1-80-08, para. 34; 3-2-1-73-10 and 3-2-1-93-10.

<sup>56</sup> CCSCd 3-2-1-42-12, para. 11; C. von Bar, E. Clive (see Note 8), p. 843.



## 5. Conclusions

The Estonian legislator has made a principal decision to provide price reduction as a separate remedy for the obligee in the LOA. In the present paper, it has been examined whether this decision was justified in consideration of the preconditions for various remedies, the results of those remedies, and also modern developments in European contract law.

Price reduction and compensation for damage are designed to protect different interests of the obligee even though, depending on the circumstances of each specific case, the use of these remedies may yield similar results. Therefore, the two must be considered as two clearly different remedies, enabling the obligee to reach different goals. Also, regardless of the fact that price reduction and termination of the contract (and, especially, partial termination of the contract) have significant similarities—both of them may be invoked regardless of the excusability of the obligor's breach of obligation and constitute rights to unilateral alteration of legal relations—in Estonian, German, and Dutch law and in the DCFR and CESL, the two are still remedies that have different functions, which cannot be achieved through other remedies. When considering the preconditions for, and consequences of, price reduction and of withholding performance, one must, regardless of a few exceptional cases, reach the conclusion that these remedies fulfil the same purposes only occasionally and are meant to protect different interests of the obligee.

Therefore, it has to be concluded that the goal of price reduction as regulated in §112 of the LOA, the CISG's Article 50, Article 120 of the CESL, the DCFR's Article III-3:101, and the BGB's §441 and §638 differs enough from the goals of other remedies. The results achieved via price reduction cannot as a rule be reached by means of other remedies analysed in this article. Therefore, the authors of this article are of the opinion that price reduction should be recognised as a separate remedy if the legislator wishes for a remedy that would aid in keeping the bargain in balance.