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Draft Common Frame of Reference and Estonian Law of Obligations Act: Similarities and Differences in the System of Contractual Liability

1. Introduction

The debate on a further and greater harmonisation of civil law has been going on in the European Union for years. The Principles of European Contract Law (PECL)¹ have been developed and published. This work has been continued by the Study Group on a European Civil Code under the leadership of Professor Christian von Bar.² As the so-called Draft Common Frame of Reference (DCFR), an integral draft model law recently has been published³ and is being further elaborated, with the promise of publication in full in December 2008. The future of the latter project, however, is a bit unclear. The role of the DCFR presumably may be to serve as a model law used as an example in preparing national and EU legislation, and in theory it may be applied similarly to *lex mercatoria* subject to agreement of the parties.⁴ It should not be likely to become, in the

¹ First version: The Principles of European Contract Law. Part I: Performance, Non-performance and Remedies. Dordrecht, Boston, London: Martinus Nijhoff Publishers 1995. Second version: Principles of European Contract Law. Parts I and II. Combined and revised. Prepared by the Commission on European Contract Law (chaired by Professor Ole Lando) and edited by Ole Lando and Hugh Beale. The Hague, London, Boston: Kluwer Law International, 2000.

² See <http://www.sgecc.net/>.

³ Principles, Definitions and Model Rules of European Private Law Draft Common Frame of Reference (DCFR). Interim Outline Edition. Prepared by the Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group) and based in part on a revised version of the Principles of European Contract Law, edited by Christian von Bar, Eric Clive, Hans Schulte-Nölke, and Hugh Beale, Johnny Herre, Jérôme Huet, Peter Schlechtriem†, Matthias Storme, Stephen Swann, Paul Varul, Anna Veneziano, and Fryderyk Zoll. Munich: Sellier, 2008, 396 pages.

⁴ For details about the CFR and its prospects for the future, see, for example, H. Beale. The Development of European Private Law and the European Commission's Action Plan on Contract Law. – *Juridica International* 2005, pp. 4–16; C. von Bar. Working Together Toward a Common Frame of Reference. – *Juridica International* 2005, pp. 17–26; C. Castronovo. Common Frame of Reference: Conciliation or Clash? – *Juridica International* 2006, pp. 25–29; Dirk Staudenmayer's piece in *Zeitschrift für Europäisches Privatrecht* (4/2003), pp. 828–846; Jürgen Basedow's piece in *Zeitschrift für Europäisches Privatrecht* (4/2003), pp. 828–846; the work of Brigitte Zypries in *Zeitschrift für Europäisches Privatrecht* (2/2004), pp. 225–233; and DCFR pp. 3–49.

foreseeable future, a legal instrument in its own right (such as a unified European civil code).⁵ In all likelihood, the DCFR cannot be capable of harmonising European private law, even on the assumption that a need exists for such a common frame of reference. Nevertheless, the DCFR signifies an important achievement of synthesising European law and employing a modern approach, first and foremost, to contract law.⁶

Six years have passed since the Estonian Law of Obligations Act (LOA)⁷ and the new General Part of the Civil Code Act (GPCCA)⁸ entered into force. This is long enough to allow for drawing initial conclusions. As the general part of the LOA and also, in part, the GPCCA make use of several solutions based on the PECL (and by extension the DCFR), it is possible to evaluate, albeit indirectly, the functioning of PECL and DCFR solutions as real and effective law in combination with other acts and regulations. The author shall concentrate in this article on the breach of contract (non-performance) and related liability provisions under the LOA and the new DCFR as these provisions represent a central array of issues in modern contract law. Although the new version of the DCFR also regulates non-contractual obligations, for the sake of brevity and in order to maintain its focus, the paper deals just with the problems related to contracts.

2. The general system of the contractual liability provisions of DCFR Book III and the LOA

Book III, Chapter 3 of the DCFR regulates remedies for non-performance. Chapter 3 is composed of material on the following: general matters (Section 1), cure by debtor of non-conforming performance (Section 2), the right to enforce performance (Section 3), withholding performance (Section 4), termination (Section 5), price reduction (Section 6), and damages and interest (Section 6).

The general system of debtor's liability under the Law of Obligations Act is similar to that of the DCFR. Breach of obligation is regulated by LOA Chapter 5, while general provisions (including liability for breach of obligation) (Division 1) and legal remedies (Division 2) are regulated separately. The legal remedies applicable to breach of obligation are also similar in the DCFR and LOA. The author believes that the LOA is structured somewhat conditionally (e.g., as regards the position of § 105⁹ in the LOA), but this has not caused any particular problems in applying the law.

3. Breach of obligation as a precondition for liability

In the LOA, breach of obligation (in Estonian, *kohustuse rikkumine*) represents the central category of contractual liability; under § 100 of the LOA, breach of obligation may be failure to perform or defective performance of a prestation, including a delay in performance, but also substandard performance. In the DCFR, the same institute is expressed with the term 'non-performance' (*täitmatajätmine*) (in DCFR article III.-1:101 (3)); however, different terms should not carry a substantial difference. Just as does the DCFR, the LOA recognises a universal category of non-performance and does not separate substandard performance from general liability.¹⁰ Such an approach should first and foremost prevent differentiation between, for example, substandard performance and non-performance, although this might remain an issue with contracts of sale. The author believes that such an approach is reasonable.¹¹

⁵ On the developments in harmonising EU civil law and on its possibilities, see P. Schlechtriem. 'Europäisierung des Privatrechts – vom Beruf unserer Zeit für ein Europäisches Privatrecht. – Juridica International 2004, pp. 27–31; Wolfgang Wurmnest's work in Zeitschrift für Europäisches Privatrecht (4/2003), pp. 714–744; Kadner Graziano's piece in Zeitschrift für Europäisches Privatrecht (3/2005), pp. 523–540; and the work of Dieter Martiny in Zeitschrift für Europäisches Privatrecht (1/2006), pp. 60–95.

⁶ For details on the preparation and system of the PECL, see O. Lando. The Structure and the Salient Features of the Principles of European Contract Law. – Juridica International 2001, pp. 4–15.

⁷ Võlaõigusseadus (adopted on 26 September 2001 and entered into force on 1 July 2002). – RT I 2001, 81, 487; 2007, 56, 375 (in Estonian).

⁸ Tsiviilseadustiku üldosa seadus (adopted on 27 March 2002 and entered into force on 1 July 2002). – RT I 2002, 35, 216; 2007, 24, 128 (in Estonian).

⁹ LOA § 105 (legal remedies independent of liability of the creditor) is located in the Division, which establishes general provisions on the breach of contract.

¹⁰ See also P. Varul, I. Kull, V. Kõve, M. Käerdi. Võlaõigusseadus I. Üldosa (§§ 1–207). Kommenteeritud väljaanne (Law of Obligations Act I. General Part. (§§ 1–207). Commented edition). Tallinn 2006 (hereinafter LOA Comm.), p. 312 (in Estonian).

¹¹ About fundamental breach of contract, see Section 8 of this article.

4. Lack of excusability or culpability, and agreements related to restriction of liability

Under the LOA, general liability for breach of contract is similar to that under the DCFR. Subsection 101 (1) of the LOA lists the important legal remedies regulated by law to which the creditor may resort if the debtor does not perform an obligation.

Subsection 103 (1) of the LOA ties liability generally to lack of excusability; i.e., if the conduct of the party who failed to perform an obligation is not excusable, the other party may apply legal remedies against the non-performing party. Thus, the general regulation is essentially the same as under article III.–3:101 (1) of the DCFR. Even if the non-performance is excusable, the other party has under § 105 of the LOA (similarly to article III.–3:101 (2) of the DCFR) the right to resort to such legal remedies as withholding of performance of the obligation, unilateral termination of the contract and reduction of the price, and (in cases of economic transactions) also demanding of a penalty for late payment. Pursuant to § 115 (1) of the LOA, the demanding of compensation for damage is clearly tied to lack of excusability. What is somewhat unclear concerns matters tied to the real performance of an obligation. One can conclude from § 105 of the LOA that, similarly to the situation under article III.–3:101 (2) of the DCFR, here lack of excusability is required in order for one to submit a claim. However, this is not laid down as a prerequisite for a claim in § 108 of the LOA, which regulates requirement of performance of an obligation; subsection 2 of that section sets forth the criteria for applicability of the requirement to perform, and in contracts of sale or for services, excusability should evidently not have any bearing, at least in cases where a substandard product was transferred to the other party. By contrast, the requirement to perform should not be tied to excusability and relief from the obligation to perform should be based not solely on excusability but strictly on the cases listed in § 108 (2) of the LOA (DCFR article III.–3:302 (2)).¹² The author believes that the DCFR also unnecessarily ties the requirement of real performance to lack of excusability, which causes only confusion. To date, the Supreme Court has held the position that in principle excusability should as a rule be essentially excluded in cases where the payment obligation is not performed.¹³ Similarly to the terms of the DCFR's article III.–3:101 (3), the LOA's § 101 (3) provides that a creditor must not rely on non-performance by a debtor, nor resort to legal remedies arising therefrom insofar as said non-performance was caused by an act of the creditor or by circumstances dependent on the creditor or by an event the risk of which is borne by the creditor.

Article III.–3:102 of the DCFR's material on the possibility of cumulation of legal remedies is matched by § 101 (2) of the LOA; i.e., under Estonian law too, a creditor may simultaneously resort to different legal remedies. In particular, a creditor always has the right to demand compensation for damage. The Supreme Court of Estonia has ruled that, on the basis of that provision, for example, reduction of price and compensation for damage, which are similar in content, must not be used in parallel.¹⁴ Such a solution concerning the cumulation of legal remedies is optimal and does not excessively restrict the parties. With the LOA, however, it is somewhat unclear whether cumulation also covers, for example, the option to cancel a contract because of error. This should be unambiguously regulated.

Article III.–3:104 of the DCFR, on excuse due to an impediment, is largely paralleled by § 103 of the LOA, under which the liability of a creditor for breach of contract is tied to lack of excusability. Article III.–3:104 (1) of the DCFR is essentially matched by §§ 103 (1) and (2) of the LOA, which provide a definition of *force majeure* (as the basis of excusability) analogous to that set forth in the DCFR. Both regulations have caused debates regarding how to 'furnish' the criterion of foreseeability in determining excusability and how to distinguish it from wrongful liability.¹⁵ Probably it would be more reasonable for both instruments, the LOA and DCFR, to further extend liability and thus reduce the theoretical possibility of escaping liability — that is, for the two instruments to extend strict liability. This would make the system clearer. The first sentence of article III.–3:104 (5) of the DCFR is essentially parallel to § 102 of the LOA, under which a debtor must notify the creditor of any impediment to performance by the debtor and of the effect of the impediment on the performance of the obligation immediately after the debtor becomes aware of the impediment.

Unlike the DCFR, the LOA recognises, in addition to the general liability existing in cases not involving *force majeure*, an exception: wrongful liability. Pursuant to § 103 (4) of the LOA, in those cases specified by law or in the contract, a person shall be liable for the breach of the contract regardless of whether the breach is excused. For instance, providers of health care services are liable for their wrongful violations under § 770 (1) of the LOA. Section 104 of the LOA defines wrongful liability and the types of culpability. Under § 104 (2)

¹² Under § 108 (2) of the LOA, performance of the obligation shall not be required if performance is impossible, performance is unreasonably burdensome or expensive for the debtor, the creditor may reasonably achieve the desired result of the performance in another manner, or the performance involves provision of services of a personal nature. See also LOA Comm., p. 348 (in Estonian).

¹³ See, e.g., the Supreme Court decision of 7 November 2005 in civil case 3-2-1-118-05 (RT III 2005, 39, 384), Sec. 16 (in Estonian).

¹⁴ See the Supreme Court decision of 30 November 2005 in civil case 3-2-1-131-05 (RT III 2005, 43, 425), Sec. 18 (in Estonian).

¹⁵ See, e.g., K. Sein. Mis on vääramatu jõud? (What Is *Force Majeure*?). – Juridica 2004/8, pp. 511–519 (in Estonian).

of the LOA, the types of culpability are carelessness, gross negligence, and intent. As an exception, the LOA also recognises liability for the level of care exercised by a person in his or her affairs (e.g., liability upon gratuitous deposit according to § 885 of the LOA). In cases involving such a duty related to the level of care, a person is nevertheless liable in the event of intent and in cases of gross negligence (LOA § 104 (6)). In view of the different relationships regulated by the LOA and the fact that the provisions cited are in part also applicable to delictual liability, the solution provided by the LOA is obviously reasonable, albeit not the only possible one.

The general provisions of the LOA do not contain a regulation comparable to article III.–3:107 of the DCFR, under which a creditor who is not a consumer may not rely on the lack of non-conformity of goods or services received, unless the creditor gives notice to the debtor within a reasonable time. However, a similar obligation of the purchaser can be found in the LOA's § 220 (pertaining to cases of contracts of sale) and of the customer in § 644 of the LOA (in relation to contracts for services). Not unlike the DCFR's article III.–3:107 (3), the LOA's § 221 (1) and § 645 (1) restrict the creditor's right to rely on failure to provide notification of non-conformity if the debtor was aware or ought to have been aware of the lack of conformity and did not disclose such information to the creditor. To sum up, the rules of the LOA and DCFR are similar and obviously reasonable.

The material in article III.–3:105 of the PECL on agreements restricting liability is reflected in § 106 of the LOA, whose subsection 1 specifies that a debtor and a creditor may agree in advance to preclude or restrict liability in the event of non-performance of an obligation. Despite the rather ambiguous wording, this provision should also cover the exclusion of resorting to different legal remedies.¹⁶ Under § 106 (2) of the LOA, agreements that allow the debtor to perform an obligation in a manner materially different from that which could be reasonably expected by the creditor or that unreasonably exclude or restrict liability in some other manner, and also agreements that preclude or restrict liability in the event of intentional non-performance, are void. Unlike the regulation provided in the LOA, article III.–3:105 (1) of the DCFR prohibits only agreements related to personal injury caused intentionally or through gross negligence. What is different in the LOA from the latter terms of the DCFR is the invalidity of all unreasonable agreements (LOA § 42) but not the prohibition to rely on them (in part) (as provided by the DCFR). Such regulation as that seen here in the DCFR would obviously be more rational, as it would allow more flexibility in application. Amending the LOA to reflect that would be desirable.

5. Cure of non-performance and deadlines for remedying lack of conformity

Articles III.–3:202 through III.–3:204 of the DCFR are resembled by § 107 of the LOA, which allows the party who fails to perform a contractual obligation to cure the non-performance; however, the LOA grants a slightly broader scope of cure for the debtor. Thus, under § 107 of the LOA, the party who fails to perform an obligation may in principle and within the limits of reason cure the non-performance (e.g., rectify or replace defective performance) until the other party has not terminated the contract or demanded compensation for damage in lieu of performing the obligation. Under § 107 (4) of the LOA, cure does not deprive the aggrieved party of the right to claim compensation for damage caused by a delay in performance or by attempted cure, including the right to claim payment of a penalty for late payment or a contractual penalty (similarly to the DCFR's article III.–3:204 (3)).

Section 114 of the LOA generally corresponds to the DCFR's article III.–3:103 on notice for fixing an additional period of performance. Granting of an additional term for performance is a general prerequisite for both withdrawal from a contract due to breach of contract (LOA § 116 (2) 5)) and cancellation, due to the same reason, of a contract entered into for an indefinite period (LOA § 196 (2)). Also, under § 115 (2) of the LOA it is a general prerequisite for demanding compensation for damage in lieu of performance. Differently from article III.–3:103 (2) of the DCFR, the LOA's § 114 (3) prescribes that the creditor may, during the additional term granted for performance, also claim a penalty for late payment. Subsection 114 (2) explains also that the granting of an additional term for performance does not release the debtor from liability for breach of contract. Clause 116 (2) 5) of the LOA, unlike article III.–3:503 (1) of the DCFR, obviously over-justifies a party's withdrawal from the contract if the other party fails to perform any obligation (not just delaying performance) during the additional term granted for performance or if said party gives notice that he will not perform the obligation during that term. Within the context of other provisions, § 116 (4) of the LOA is also a bit unclear, tying withdrawal from a contract to granting of an additional term for non-performance (see Section 8 of this article).

¹⁶ See LOA Comm., p. 338 (in Estonian).

6. Requirement of real performance

Article III.–3:301 (1) of the DCFR's regulation of monetary obligations is in essence matched by § 108 (1) of the LOA, which in principle grants the creditor an indefinite right to demand performance of a monetary obligation. The Supreme Court has found that non-performance of a monetary obligation is, as a rule, not excusable.¹⁷ The LOA does not have a regulation corresponding to the rather 'heavy' article III.–3:301 (2) of the DCFR concerning unwillingness of the debtor to receive the creditor's performance. Subsection 109 (1) of the LOA includes a somewhat similar idea: In the case of a mutual contract, the party in breach of obligation may require the other party to perform its obligations even if performance by the party in breach cannot be required for reasons specified in § 108 (2) of the LOA and if the reason arises because of circumstances dependent on the other party or if the reason arises at the time when the other party delays acceptance. This ensures that the creditor still has a right of counterclaim. In addition, § 109 (2) of the LOA provides that the party in breach must nevertheless deduct from its claim whatever it saves as a result of non-performance or obtains as a result of applying its labour or other resources elsewhere or what it in bad faith fails to obtain, despite having a reasonable opportunity to obtain it. Additionally, for example, a seller has the right to withdraw from the contract and claim damages if the purchaser refuses to accept the goods. Also, under § 115 (2) of the LOA, the seller may demand compensation for damage in lieu of performance.

Section 108 of the LOA is similar to article III.–3:302 of the DCFR in its handling of non-monetary obligations; i.e., under Estonian law too it is possible to demand, in court, real performance of an obligation other than payment of money, albeit subject to restrictions arising from law.¹⁸ Not unlike article III.–3:302 (3) of the DCFR, the second sentence of § 108 (2) of the LOA restricts the enforcement of a claim for real performance, and the specific restrictions listed in the LOA and DCFR overlap. However, the meaning of the restrictions is not always absolutely clear, as is the case with a claim to replace a defective item sold under a contract of sale. One should perhaps prefer the interpretation according to which such restrictions are not overly important, and § 222 of the LOA should be applied in the case of sale. Article III.–3:302 (4) of the DCFR is matched by § 108 (3) of the LOA. That is, under Estonian law too a creditor is required to decide as quickly as possible whether to continue to demand real performance of the obligation that was breached. In addition, § 108 (4) of the LOA stipulates that a debtor may determine beforehand a reasonable term within which the creditor may require performance and if the debtor specifies an unreasonably short term within which the creditor may require performance, the term is deemed to have been extended to a reasonable length. In practice, however, the reasonability of the temporal restriction on a claim of performance has been questioned, particularly in parallel with the existence of limitation periods. This causes somewhat unnecessary disputes, and it would be preferable to waive such a restriction.¹⁹ Nevertheless, as far as is known, this particular regulation has not caused major court cases to date.

7. Withholding performance of a contract

Compared to article III.–3:401 of the DCFR, the LOA regulates withholding of performance more broadly and with greater detail (in its §§ 110 and 111). However, several inaccuracies can be found in the LOA.

Article III.–3:401 (1) of the DCFR is similar to § 111 (1) of the LOA, but, unlike the DCFR, the LOA does not clearly specify that it pertains to only the right to withdraw performance of the party who is required to perform after or simultaneously with the other party. Even so, one should come to this conclusion on the basis of the logic of the provision.²⁰ In addition, under § 111 (1) of the LOA, the right to withhold performance terminates also where the other party has performed or offered to perform (obviously without basis) and has secured or confirmed the performance. Subsection 111 (3) of the LOA is similar to article III.–3:401 (4) of the DCFR (although the LOA regulation is broader in scope), according to which a party shall not withhold performance if this would be unreasonable in the circumstances or contrary to the principle of good faith, in particular if the other party has performed the obligations thereof for the most part or without significant deficiencies.

The option of the creditor to withhold performance when he reasonably believes there will be non-performance by the debtor as set out in article III.–3:401 (2) of the DCFR is regulated in detail in §§ 111 (4)–(6) of the LOA.

In addition to regulating performance in cases of mutual contract, § 110 of the LOA grants a debtor a broader right to withhold performance of an obligation until the creditor has satisfied a claim that is due for the benefit of the debtor against the creditor (also, for example, a claim from another contract or other prestation) if the claim is not sufficiently secured and there is a sufficient link between the claim and the obligation of the debtor,

¹⁷ See CCSCd No. 3-2-1-118-05, Sec. 16 (in Estonian).

¹⁸ For discussion of the meaning of excusability in cases of a claim of real performance, see Section 4 of this article.

¹⁹ See LOA Comm., p. 351 (in Estonian).

²⁰ See LOA Comm., 365 (in Estonian).

and unless indicated otherwise by the law, the contract, or the nature of the obligation (LOA § 110 (1)). Section 110 of the LOA regulates that right in detail. The author believes that the general regulation of § 110 concerning the right to withdraw performance is reasonable, as it improves the position of the aggrieved party.

8. Unilateral termination of contract

Comparable regulation to article III.–3:502 (1) of the DCFR on unilateral termination of contract can be found in § 116 of the LOA. That is, also under Estonian law a party may unilaterally terminate a contract in the event of fundamental breach of contract (LOA § 116 (1)). The main instances of fundamental breach of contract are listed in § 116 (2). Provisions related to the granting of an additional term for performance can be found in subsections 4 and 5 of § 116 of the LOA. Under the LOA, the fundamental nature of the breach is also important if compensation for damages in lieu of performance is demanded (see its § 115 (2) and (3)), and also, in the case of contracts of sales and services, if upon the emergence of lack of conformity of an item the delivery of a substitute thing is demanded (see LOA § 222 (2) and § 646 (2)). That the alleged breach of contract is of a fundamental nature is also important if a party withdraws itself from performance (LOA § 111 (6)).

Article III.–3:502 (2) (a) of the DCFR is in essence matched by § 116 (2) 1) of the LOA, under which a breach of contract is fundamental if non-performance of an obligation substantially deprives the aggrieved party of what said party was entitled to expect under the contract, except in cases where the other party did not foresee such consequences of the non-performance and a reasonable person of the same kind as that second party could not have foreseen such consequences under the same circumstances. The DCFR does not have a separate provision with the effect of the LOA's § 116 (2) 2), under which a breach is fundamental if, pursuant to the contract, strict compliance with the obligation that has not been performed is the precondition for the other party's continued interest in the performance of the contract. Unlike article III.–3:502 (2) (b) of the DCFR, § 116 (2) 3) of the LOA prescribes that a breach may be deemed fundamental even simply if non-performance of some obligation was intentional or (additionally to the conditions set forth in the DCFR) due to gross negligence, and § 116 (2) 4) specifies that a breach is fundamental if non-performance of the obligation gives the aggrieved party reasonable reason to believe that it cannot rely on the other party's future performance. Thus, the important regulation of the DCFR provision has been divided in the LOA into two separate bases with, at the same time, addition of gross negligence to the list. Such a solution is obviously not the best, as it allows treating rather insignificant breaches of contract as fundamental. What is also not clear is differentiation of § 116 (2) 4) of the LOA from termination of contract, for example, on the basis of alleged breach of contract under § 117 (1) of the LOA.²¹ Differently from DCFR article III.–3:503 (1), § 116 (2) 5) of the LOA stipulates that any breach is fundamental if the other party fails to perform any obligation thereof during an additional term for performance or gives notice that it will not perform the obligation during this term (see also Section 5 of this article). Also, it is unclear how to apply the bases listed in the LOA's § 116 (2) 1), 3), and 4) in conjunction with § 116 (4) of the LOA, under which withdrawal from a contract without granting of an additional term for performance is prohibited if the damage suffered by the non-performing party in the case of withdrawal would be disproportionate to the expenses incurred in the performance or preparation for the performance of the obligation. Unlike the DCFR's article III.–3:502 (2), the list in § 116 (2) of the LOA is not exhaustive. Subsection 117 (1) of the LOA in essence corresponds to article III.–3:504 of the DCFR; i.e., under Estonian law as well it is possible to withdraw from a contract before a fundamental breach of the contract actually happens, if such a situation arising is evident.

Differently from the DCFR, the LOA makes a more detailed differentiation of contracts entered into for an indefinite period that are contracts for the performance of a continuing obligation or recurring obligations (LOA § 195 (3)). Under the LOA's § 116 (6), in the case of a fundamental breach of a contract entered into for an indefinite period, the aggrieved party may cancel the contract pursuant to the provisions of § 196 of the LOA. Unilateral termination of any other contract is called withdrawal. The difference lies in the existence of reversal of the contract (in the case of withdrawal) or the lack of it (in the case of cancellation). Nevertheless, the bases for unilateral termination in the case of fundamental breach of a contract are, pursuant to § 196 (2) of the LOA, still the same and are grounded in § 116 of the LOA. However, under § 196 (1) of the LOA, a contract entered into for an indefinite period may extraordinarily be cancelled with good reason without giving of advance notice, in particular if the party cancelling the contract cannot reasonably be expected to continue performing the contract until the due date agreed upon or until expiry of the term for advance notice, with all of the circumstances and the mutual interests of the parties taken into account. It is most likely that, in the LOA too, a unified approach to termination would have been possible, but with different types of contract there still remains the need to allow termination of a contract on account of circumstances arising from the party wishing to terminate the contract — and this is what § 196 of the LOA enables. Therefore, the solution provided by the LOA is not necessarily worse than that of the DCFR.

²¹ See LOA Comm., p. 404 (in Estonian).

Analogously to article III.–3:507 (1) of the DCFR, pursuant to § 188 (1) of the LOA withdrawal from a contract occurs by the withdrawing party's submitting a declaration of withdrawal to the other party. Under § 195 (1) of the LOA, contracts entered into for an indefinite time are also cancelled by a declaration to the other party. Accordingly, under Estonian law it is not necessary, for example, to file an action with a court in order to unilaterally terminate a contract. Similarly to article III.–3:508 (1) of the DCFR, § 118 (1) 1) of the LOA sets out that a party entitled to withdraw from a contract loses the right to withdraw if said party does not make a declaration of withdrawal within a reasonable time after it becomes or should have become aware of a fundamental breach of the contract. Clause § 118 (1) 2) of the LOA furthermore stipulates that withdrawal must also occur within reasonable time after expiry of the additional term for performance. The LOA's § 118 (2) provides for the, so to say, final deadline of withdrawal — withdrawal from a contract due to a breach of the contract is void if the claim for the performance of the obligation has expired and the debtor relies on such a claim or if the debtor legitimately refuses to perform the obligation.

Subsections 188 (2) and (3) of the LOA in essence correspond to article III.–3:509 of the DCFR. That is, also under Estonian law withdrawal from a contract does not have a retroactive effect *per se*; i.e., it does not affect the validity of rights and obligations that have arisen from the contract before the withdrawal but, rather, releases the parties from further performance of the contract. Under § 195 (2) of the LOA, the consequences of withdrawing from a contract entered into for an indefinite period are virtually the same. Withdrawal additionally has a significant consequence of reversal of contract under §§ 189–191 of the LOA; exceptionally this may also be a consequence of cancellation under § 195 (5) of the LOA. The LOA's regulation of return of property upon termination and compensation for its value is in principle similar to articles III.–3:511–III.–3:515 of the DCFR. According to those provisions, that which was delivered under the contract must mutually be returned, and, if this is not possible, the value of that which was received must be compensated for in money. There is also detailed regulation of the impossibility of the obligation to return, payment of compensation for use of that which was delivered, compensation for costs incurred through that which was delivered, etc. Compared to the earlier regulation of the PECL, the solution provided by the DCFR is much clearer and actually more similar to that of the LOA.

9. Reduction of price

Article 3:601 of the DCFR, on price reduction, is mostly matched by § 112 of the LOA; i.e., under Estonian law too, the general legal remedy of unilateral reduction of price upon acceptance of defective performance is possible. Only the breach of a contract through defective performance and not lack of excusability is a precondition for the reduction of price (§ 105 LOA). Reduction of price has acquired an important place in Estonian court practice.

The LOA does not have a provision matching article III.–3:601 (3) of the DCFR on delimiting price reduction from claiming of compensation for damages; however, the practical application should yield a similar result. On the basis of § 101 (2) of the LOA, price reduction and compensation for damages may be used in parallel but only to such an extent that they do not preclude each other. The Supreme Court has decided that parallel demanding of price reduction and compensation for damages is not allowed.²² This position, however, obviously covers demanding of compensation for damages that goes in the same direction as the reduction of price. The LOA's § 112 (2) further regulates the procedure for price reduction. According to that provision, price reduction is performed by making a corresponding declaration to the other party. The position of the Supreme Court is that such a declaration may be in any form.²³

Both the DCFR's article III.–3:601 and the LOA's § 112 are imperfect in that the period during which one may resort to price reduction is not clear.

10. Compensation for damage due to breach of contract

The LOA's regulation of compensation for damage is similar in essence to that of the DCFR, although it is structured a bit differently and is more detailed. Basically, the general requirement to compensate for damage due to breach of a contract is regulated, as a legal remedy, in § 115 of the LOA; the extent and calculation of compensation are, on the other hand, jointly regulated both for the purposes of the contract and for applica-

²² See CCSCd 3-2-1-131-05, Sec. 18 (in Estonian).

²³ See the Supreme Court decision of 14 June 2006 in civil case 3-2-1-59-06 (RT III 2006, 25, 229), Sec. 16 (in Estonian).

tion of delict law in §§ 127–140 of the LOA. The law of delict, together with the bases for the claim, can be found in §§ 1043–1067 of the LOA. Subsection 1044 (2) of the LOA contains an important stipulation that compensation for damage arising from the violation of contractual obligations may not be claimed on a delictual basis except in cases where the objective of the violated contractual obligation was other than to prevent the damage for which compensation is claimed. Under § 1044 (3) of the LOA, claims may be submitted both on a contractual and on a delictual basis in cases involving causing of death, bodily injury, or damage to the health of a person.

Similarly to article III.–3:701 (1) of the DCFR, § 115 (1) of the LOA provides that, in the case of non-performance of an obligation by a debtor, the creditor may along with or in lieu of performance claim compensation for that damage caused by the non-performance from the debtor, except in cases where the debtor is not liable for the non-performance (i.e., where the non-performance is excusable under § 103 of the LOA) or the damage is not subject to compensation for any other reason specified by law. The LOA's § 115 draws a clear distinction between a claim for compensation of damage together with performance of the obligation (the so-called 'small claim for compensation of damage') and a claim for compensation of damage in lieu of performance (the so-called 'big claim for compensation of damage'). The language in §§ 115 (2)–(4) provides, similarly to the provisions on withdrawal, more precise regulation of a claim for compensation of damage in lieu of performance (such a delimitation may cause problems, primarily in connection with extinguishment of a claim). Under §§ 146–148 of the General Part of the Civil Code Act, the limitation period of a claim for compensation for damage arising from a contract or pre-contractual negotiations (both including and in lieu of performance) is three years from its falling due — i.e., from the time at which one may start demanding compensation.

In essence, the LOA's regulation here is similar to that of articles III.–3:701 (2) and (3) and article III.–3:702 of the DCFR both as regards the extent of compensation and as concerns the types of damages subject to compensation. Under § 127 (1) of the LOA, the purpose of compensation for damage is to place the aggrieved person in a situation as near as possible to that in which said person would have been if the circumstances that form the basis for the compensation obligation had not occurred. In Estonian judicial practice, compensation for damage is known as expectation interest or positive damage as well as negative damage or reliance interest, for example, in the case of nullity of contract or upon breach of an obligation arising from pre-contractual negotiations.²⁴ Damage suffered by an aggrieved person is one of the preconditions for the arising of the obligation to compensate.²⁵ According to § 127 (5) of the LOA, any gain received by the aggrieved party as a result of the damage caused — in particular, the costs avoided by the aggrieved party — must be deducted from the compensation for damage, unless deduction is contrary to the purpose of the compensation. Under the LOA's § 128 (1), damage subject to compensation may be either patrimonial or non-patrimonial. Pursuant to § 128 (2), patrimonial damage includes, primarily, direct patrimonial damage and loss of profit. The special provisions of the LOA specify the extent of compensation in cases of violation of concrete legal rights: causing the death of a person (LOA § 129); causing harm to the health or causing bodily injury (LOA § 130 (1)); deprivation of liberty or violation of personality rights (LOA § 131); destruction, loss of, and/or damage to property (LOA § 132); and damage caused by activities that are hazardous to the environment (LOA § 133). According to § 128 (5) of the LOA, non-patrimonial damage involves primarily the physical and emotional distress and suffering caused to the aggrieved person. The extent of compensation for non-patrimonial damage is further specified primarily in § 134 of the LOA. Pursuant to § 134 (1) of the LOA, compensation for non-patrimonial damage arising from non-performance of a contractual obligation may be claimed only if the purpose of the obligation was to pursue a non-patrimonial interest and, under the circumstances relating to entry into the contract or to the non-performance, the debtor was aware or should have been aware that non-performance could cause non-patrimonial damage. With different prerequisites, non-patrimonial damage is subject to compensation also in cases of causing of either damage to the health or bodily injury to a person (LOA § 130 (2)), violation of personality rights (LOA § 134 (2)), causing of the death of a person (in which case compensation is payable to persons close to the deceased) (LOA § 134 (3)), and destruction or loss of a thing (LOA § 134 (4)). Under the LOA's § 127 (6), if damage has been established but the exact extent of that damage cannot be established, including in the event of non-patrimonial damage or future damage, the amount of compensation shall be determined by the court. The same regulation in essence arises from § 233 (1) of the Code of Civil Procedure²⁶. The LOA's § 135 (1), which allows substitute transaction as the basis for calculating the compensation, is similar to the DCFR's article III.–3:706; § 135 (2) of the LOA, allowing for using current prices as the basis in calculation of the compensation, is similar to article III.–3:706 of the DCFR.

Subsection 127 (3) of the LOA is basically the same as article III.–3:703 of the DCFR; that is, in the event of breach of a contract, the non-conforming party must compensate for only such damage as said party foresaw or should have foreseen as a possible consequence of non-performance at the time of entering into the contract,

²⁴ See, for instance, the Supreme Court 21 October 2003 decision in civil case 3-2-1-106-03 (RT III 2003, 33, 342), Sec. 14–17 (in Estonian).

²⁵ See the Supreme Court decision of 13 February 2002, in civil case 3-2-1-14-02. — RT III 2002, 8, 80 (in Estonian).

²⁶ Tsviilkohutumenetluse seadustik. — RT 2005, 26, 197; 2007, 16, 77 (in Estonian).

unless the damage has been caused intentionally or through gross negligence.^{*27} In addition, according to § 127 (2) of the LOA, the damage is not to be compensated for to the extent that prevention of damage was not the purpose of the obligation or provision due to the non-performance of which the compensation obligation arose (that is, the so-called ‘theory of the purpose of the law’).^{*28} Pursuant to § 127 (4) of the LOA, a person must compensate for damage only if the circumstances on which the liability of that person is based and the damage caused are related in such a manner that the damage is a consequence of the circumstances (i.e., there is a causal relationship). To date, court practice has not provided an exhaustive answer concerning application of different elements of §§ 127 (2)–(4) in conjunction with each other.^{*29}

Under § 136 (1) of the LOA, damage is to be compensated for in a lump sum unless the nature of the damage makes it reasonable to pay the compensation in instalments. Pursuant to § 136 (5) of the LOA, in the cases specified by law or a contract and in other cases where this is reasonable under the circumstances, the aggrieved person may claim compensation for damage in a manner other than monetary compensation. The language in § 137 of the LOA further specifies the compensation for damage to be paid by several persons and stipulates, *inter alia*, solidary liability for payment of compensation (LOA § 137 (1)). Judicial practice provides an example of such a situation. The court decided that, under § 137 (1) of the LOA, an employee and a third party were solidarily liable for damage caused to an employer’s car, with the employee being held liable for breach of the employment contract and the third party found guilty on the basis of provisions regulating unlawful damage.^{*30} The LOA’s § 138 makes it simpler for the aggrieved party to claim compensation where several persons may be liable for the damage caused and it has been established that any of these persons could have caused the damage. In such a case, according to the LOA’s § 138 (1), compensation for the damage may be claimed from all such persons. Under § 138 (3) of the LOA, this compensation may be claimed only to an extent that is in proportion to the probability that the damage was caused by the person concerned. The Supreme Court has ruled that these principles may be applied, for example, to builder’s and designer’s liability for defective construction.^{*31}

The LOA’s regulation, although somewhat broader in scope, is similar in essence to article III.–3:705 of the DCFR in its handling of reduction of loss. Pursuant to § 139 (1) of the LOA, if the damage is caused in part by circumstances dependent on the aggrieved party or due to a risk borne by the aggrieved party, the amount of compensation for the damage shall be reduced to the extent that such circumstances or risk contributed to the damage. Under § 139 (2) of the LOA, this provision also applies if the aggrieved person failed to draw the attention of the person causing the damage to an unusually high risk of damage or to prevent the risk of damage, or failed to perform any act that would have reduced the damage caused if the aggrieved person could have reasonably been expected to do so. In § 139 (3) and (4), the LOA specifies the details of reduction of compensation in the case of damage to a person. The Supreme Court has expressed the position that, for instance, if the debtor failed to supply to a factory the quantity of raw materials prescribed by the contract, the factory, as the creditor, could be assumed to perform a substitute transaction — i.e., reduce their damage for the purposes of § 139 (2) of the LOA.^{*32} The LOA’s regulation corresponding to DCFR article III.–3:705 (2) can be found in § 128 (3), according to which direct patrimonial damage includes, *inter alia*, reasonable expenses related to prevention or reduction of damage. Pursuant to § 140 (1) of the LOA, the court may reduce the amount of compensation for damage if compensation in full would be grossly unfair with respect to the obligated person or for any other reason not be reasonably acceptable. In such cases, all circumstances — in particular, the nature of the liability, relationships between the persons, and their economic situations (including insurance coverage) — must be taken into account.

11. Penalty for late payment and contractual penalty

Similarly to article III.–3:708 of the DCFR, § 113 of the LOA provides for a general opportunity to require, upon a delay in the performance of a monetary obligation, payment of a penalty for late payment, although the LOA is much more detailed in its regulation. Under the LOA’s § 113 (1), interest on the delay (that is, a penalty for late payment) may be claimed for the period from the time the obligation falls due until conforming performance is rendered, at the interest rate specified in § 94 of the LOA^{*33} — the last interest rate applicable to the main refinancing operations of the European Central Bank before 1 January or 1 July of each

²⁷ See, for example, the Supreme Court 6 March 2003 decision in civil case 3-2-1-19-03 (RT III 2003, 7, 78), Sec. 12 (in Estonian).

²⁸ See LOA Comm., pp. 440–441 (in Estonian).

²⁹ See, for example, the Supreme Court 26 September 2006 decision in civil case 3-2-1-53-06 (RT III 2006, 33, 283), Sec. 13 (in Estonian).

³⁰ See the Supreme Court 7 December 2005 decision in civil case 3-2-1-149-05 (RT III 2005, 45, 441), Sec. 12 (in Estonian).

³¹ See the Supreme Court decision of 21 May 2002 in civil case 3-2-1-56-02 (RT III 2002, 16, 194), Sec. 24 (in Estonian).

³² See the Supreme Court 21 December 2005 decision in civil case 3-2-1-137-05 (RT III 2006, 3, 26), Sec. 12 (in Estonian).

³³ Directive 2000/35/EC of the European Parliament and of the Council of 29 June 2000, on combating late payment in commercial transactions.

year plus seven per cent per year. If a contract prescribes payment of interest exceeding the rate provided for by law, the interest rate prescribed by the contract is to be the rate of penalty for late payment. In the case of contracts entered into in economic or professional activities, the penalty for late payment is calculated on the basis of the second sentence of § 105, irrespective of the excusability of the non-performance; in other cases where non-performance is not excusable, § 103 of the LOA shall be taken as the basis. Analogously to article III.–3:708 (2) of the DCFR, subject to the existence of the other prerequisites, it is possible to claim under § 113 (5) of the LOA compensation for the sum in excess of the penalty for late payment if the damage caused by the delay in performance exceeds the amount of the fine specified for the delay. The LOA's § 113 (2) specifies further that if compensation for damage is required for reasons other than non-performance of an obligation to pay money, the penalty for late payment of the sum of the compensation shall be calculated as of the moment when the person required to compensate for the damage became or should have become aware of the damage caused.

What differs fundamentally from the DCFR's article III.–3:709 is the regulation of § 113 (6) of the LOA, which prohibits requirement of a penalty for late payment for a delay in payment of interest. Agreements that derogate from this requirement to the detriment of the debtor are void. Pursuant to § 113 (7) of the LOA, this does not, however, preclude or restrict the right of the creditor to claim compensation for damage caused by a delay in the payment of interest. A person required to pay a penalty for late payment may, under § 113 (8) of the LOA, make a claim for a reduction of the fine pursuant to the provisions of § 162 of the LOA. In the practice of the Supreme Court of Estonia, any reduction of the fine is granted at the discretion of the court and in consequence of weighing the interests of the debtor and the creditor, comparing the amount of the claim to the amount of the loss caused to the creditor, and estimating its proportionality.^{*34} Unreasonably high penalties foreseen in standard terms serve as an exception here. In such a case, the court should not reduce the penalty rate but, on the basis of § 42 (3) of the LOA, deem the agreement void. As a result, only the statutory penalty can be claimed in the latter case.^{*35}

The LOA's regulation of contractual penalty terms (in §§ 158–163) is similar to what is set forth in the DCFR's article III.–3:710, although the former is much more detailed. According to § 161 (1) of the LOA, in the case of non-performance of a contract, the aggrieved party may claim payment of a contractual penalty regardless of the actual damage. If an aggrieved party has the right to claim compensation for damage incurred because of non-performance of the contract, compensation under § 161 (2) of the LOA must be paid to the extent not covered by the contractual penalty; i.e., the aggrieved party may additionally require compensation for the amount exceeding the contractual penalty. The language of § 159 (1) of the LOA specifies that if a contractual penalty is agreed upon for the occasion of non-performance of an obligation, the aggrieved party may make claim for performance of the obligation in addition to payment of the contractual penalty. A claim cannot be made for performance of the obligation in addition to payment of a contractual penalty if the contractual penalty was agreed upon as a substituted performance and not as a means for achieving performance. Under the LOA's § 160, if non-performance is excusable, a contractual penalty cannot be claimed unless otherwise prescribed by the contract. According to § 159 (2) of the LOA, an aggrieved party loses the right to claim payment of a contractual penalty if the party fails to notify the other party within reasonable time after becoming aware of the non-performance that it is claiming payment of the contractual penalty. Similarly to the DCFR's article III.–3:701 (2), under § 162 of the LOA it is possible to ask the court to reduce the contractual penalty.

12. Conclusions

To sum up, we can say that the LOA is in principle similar to the DCFR in its regulation of consequences of breach of contract and in the applicable system of legal remedies. The LOA contains several inaccuracies in details concerning, for example, prerequisites to unilateral termination of contract and rights of withdrawal from performance. At the same time, some regulation provided in the LOA is much more precise and protects the interests of the parties better (e.g., that of compensation for damage). Compared to the PECL, the terms in the DCFR in several parts show significant improvements (e.g., the material on consequences of terminating a contract). However, there are still shortcomings suffered by both the LOA and the DCFR, such as the unclear connection between the requirement of real performance, questionable regulation of temporal restriction on the submission of a claim of performance, and the deadline for reduction of price. However, as a whole these do not affect this obviously modern and relevant system of contractual liability.

³⁴ See, for example, the Supreme Court 14 June 2005 decision in civil case 3-2-1-66-05 (RT III 2005, 23, 245), Sec. 16 (in Estonian).

³⁵ See CCSCd No. 3-2-1-66-05, Sec. 24 (in Estonian).