

**UNIDROIT**

International Institute for the Unification of Private Law

# **UNIDROIT PRINCIPLES**

**OF INTERNATIONAL COMMERCIAL CONTRACTS**

**2010**

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## *FOREWORD TO THE 2010 EDITION*

*In presenting this third edition of the UNIDROIT Principles of International Commercial Contracts, we would like to begin by expressing our deepest appreciation to the Members of the Working Group, and in particular to the Rapporteurs on the new chapters. We also wish to express our gratitude to the numerous Observers who have attended the sessions of the Working Group in representation of important international organisations and other interested institutions and arbitration associations. It was only on account of the outstanding competence and extraordinary efforts of all those experts, again so ably coordinated by Michael Joachim Bonell, that this new edition of the UNIDROIT Principles was made possible.*

*We would again also like to thank those who, through scholarly writings or by applying the UNIDROIT Principles in practice, have contributed to their great success of the Principles. The comments they made and their practical experience have been an inestimable source of inspiration to the Working Group, and we hope they will continue to share with us in the future their experience with the Principles.*

*A special word of thanks goes to Henry Gabriel who, together with Michael Joachim Bonell and Ms Lena Peters of the UNIDROIT Secretariat, undertook the important task of editing the new chapters and harmonising style and language throughout the entire volume.*

*Our gratitude also goes to the other members of the Secretariat, in particular Ms Paula Howarth, Secretary to the Working Group, and Ms Frédérique Mestre and Ms Marina Schneider for preparing the French language version of the Principles in co-operation with the francophone Members of the Working Group.*

*Last but by no means least, we would like to express our deepest appreciation to the Max-Planck-Institut für ausländisches und internationales Privatrecht (Hamburg) and its Director Reinhard Zimmermann for the generous financial and logistic support provided.*

*José Angelo Estrella Faria  
Secretary-General*

*Alberto Mazzoni  
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## INTRODUCTION TO THE 2010 EDITION

When it approved the 2004 edition of the UNIDROIT Principles of International Commercial Contracts the Governing Council recalled that the Principles were one of the Institute's most successful projects and recommended that they figure in the Work Programme as an ongoing project. To this effect it instructed the Secretariat not only to continue to monitor the use of the Principles in actual practice but also to undertake at an appropriate time an inquiry among the international legal and business communities to determine new topics for inclusion in a future third edition of the Principles.

The new 2010 edition of the UNIDROIT Principles, like the 2004 edition, is not intended as a revision of the previous editions. As amply demonstrated by the extensive body of case law and bibliography reported in the UNILEX database <[www.unilex.info](http://www.unilex.info)>, the UNIDROIT Principles continue to be well received generally and have not given rise in practice to any significant difficulties of application. Consequently, the content of the 2004 edition has been altered only marginally: only five provisions have been amended, i.e. Articles 3.1 (now 3.1.1), 3.19 (now 3.1.4), paragraph 2 of Article 3.17 (now 3.2.15), paragraph 1 of Article 7.3.6 (now 7.3.6) and paragraph 2 of Article 7.3.6 (now 7.3.7), and of these only the last three have been amended in substance so as to justify their transformation into separate articles; as to the Comments, significant changes have been made only with respect to Comments 2, 3 and 4 to Article 1.4.

The main objective of the third edition of the UNIDROIT Principles was to address additional topics of interest to the international business and legal communities. Thus 26 new articles have been added dealing with restitution in case of failed contracts, illegality, conditions, plurality of obligors and of obligees.

As a result, the 2010 edition of the UNIDROIT Principles consists of 211 Articles (as opposed to the 120 Articles of the 1994 edition and the 185 Articles of the 2004 edition) structured as follows: Preamble (*unchanged*); Chapter 1: General provisions (*unchanged*); Chapter 2, Section 1: Formation (*unchanged*), Section 2: Authority of agents (*unchanged*); Chapter 3, Section 1:

## UNIDROIT Principles

General provisions (*containing former Articles 3.1 (amended), 3.2, 3.3 and 3.19 (amended)*), Section 2: Ground for avoidance (*containing former Articles 3.4 to 3.16, 3.17 (amended), 3.18 and 3.20, and a new Article 3.2.15*), Section 3: Illegality (*new*); Chapter 4: Interpretation (*unchanged*); Chapter 5, Section 1: Content (*unchanged*), Section 2: Third Party Rights (*unchanged*), Section 3: Conditions (*new*); Chapter 6, Section 1: Performance in general (*unchanged*), Section 2: Hardship (*unchanged*); Chapter 7, Section 1: Non-performance in general (*unchanged*), Section 2: Right to performance (*unchanged*), Section 3: Termination (*containing former Articles 7.3.1 to 7.3.5, 7.3.6 (amended) and a new Article 7.3.7*), Section 4: Damages (*unchanged*); Chapter 8: Set-off (*unchanged*); Chapter 9, Section 1: Assignment of rights (*unchanged*), Section 2: Transfer of obligations (*unchanged*), Section 3: Assignment of contracts (*unchanged*); Chapter 10: Limitation periods (*unchanged*); Chapter 11, Section 1: Plurality of obligors (*new*), Section 2: Plurality of obligees (*new*). For ease of comparison a table of correspondence of the articles of the three editions of the UNIDROIT Principles has been included in this volume.

In presenting the first edition of the UNIDROIT Principles the Governing Council expressed its confidence that the international legal and business communities to which the Principles were addressed would appreciate their merits and benefit from their use. The success of the second edition did not fall short of the Governing Council's expectations. It is hoped that the 2010 edition of the UNIDROIT Principles will be as favourably received as the previous editions and become even better known and more widely used throughout the world.

THE GOVERNING COUNCIL OF UNIDROIT

Rome, May 2011

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Secretaries to the Working Group were Paula HOWARTH and Lena PETERS of the UNIDROIT Secretariat



## *FOREWORD TO THE 2004 EDITION*

*It is with the utmost pleasure that we present this new edition of the UNIDROIT Principles of International Commercial Contracts which comes exactly ten years after the appearance of the first edition.*

*We would like first of all to express the Institute's deepest appreciation and gratitude to the Members of the Working Group and observers for their achievement and, among them, especially to the Rapporteurs on the various chapters. It was only on account of their outstanding competence and extraordinary efforts, again so proficiently coordinated by Michael Joachim Bonell, that this new edition was made possible.*

*We would also like to thank all those who have, over the last years, through their scholarly writings on the UNIDROIT Principles or by applying them in practice contributed to their great success. Their comments and practical experience have been an inestimable source of inspiration to the Working Group in its deliberations. It is our hope that they will continue their support and will also share with us in the future their experience with the UNIDROIT Principles.*

*Last but by no means least, our gratitude also goes to the UNIDROIT Secretariat, in particular to Ms Paula Howarth and Ms Lena Peters for their invaluable editorial assistance and to Ms Marina Schneider for her efficiency in looking after the French version in co-operation with the francophone Members of the Working Group.*

*Herbert Kronke  
Secretary-General*

*Berardino Libonati  
President*

## INTRODUCTION TO THE 2004 EDITION

When the Governing Council decided in 1994 to publish the UNIDROIT Principles of International Commercial Contracts, it stressed the need to monitor their use with a view to their possible reconsideration at some time in the future. Three years later work was resumed with a view to preparing a second edition of the UNIDROIT Principles. To this end, a Working Group was set up composed of eminent jurists representing the major legal systems and/or regions of the world. Some of its members had already participated in the preparation of the 1994 edition of the UNIDROIT Principles, while for the first time representatives of interested international organisations and arbitration centres or associations were invited to attend the Working Group's sessions as observers.

The new edition of the UNIDROIT Principles, appearing ten years after the first edition, is not intended as a revision of the 1994 edition. As is amply demonstrated by the extensive body of case law and bibliography reported in the UNILEX database <[www.unilex.info](http://www.unilex.info)>, the UNIDROIT Principles have generally met with approval and have not given rise in practice to any significant difficulties of application. Consequently, only very few amendments of substance were made to the 1994 text and these were moreover limited, with one exception, to the comments. Indeed, the only black letter rule amended was Article 2.8(2) which has now become Article 1.12. As to the comments, Comment 3 to Article 1.3, Comments 1 and 2 to Article 1.7, Comment 2 to Article 2.15 (now 2.1.15) and Comment 2 to Article 6.2.2 were substantially revised or expanded.

However, it was decided to consider whether and, if so, to what extent the 1994 edition of the UNIDROIT Principles required additions or amendments to adapt it to the increasingly important practice of electronic contracting. Eventually, only a few changes were made to this effect to the black letter rules (see Article 1.2, Article 2.8(1) (now 2.1.8), Article 2.18 (now 2.1.18)), while more changes were made to the comments and illustrations (see Comment 1 to Article 1.2, Comments 1 and 4 to Article 1.9 (now 1.10) and Illustrations, Comment 3 to Article 2.1 (now 2.1.1) and Illustration, Comment to Article 2.7 (now 2.1.7) and Illustration, Comment to Article 2.8 (now 2.1.8)).

## UNIDROIT Principles

The main purpose of the new edition of the UNIDROIT Principles is to cover additional topics of interest to the international legal and business communities. Thus, five new chapters were prepared dealing with authority of agents, third party rights, set-off, assignment of rights, transfer of obligations and assignment of contracts, and limitation periods. Furthermore, two new articles were included in Chapter 1 and Chapter 5, respectively dealing with inconsistent behaviour (Article 1.8) and release by agreement (Article 5.1.9).

As a result, the 2004 edition of the UNIDROIT Principles consists of 185 articles (as opposed to the 120 Articles of the 1994 edition) structured as follows: Preamble (*1994 version, with the addition of paragraphs 4 and 6 as well as the footnote*); Chapter 1: General Provisions (*1994 version, with the addition of Articles 1.8 and 1.12*); Chapter 2, Section 1: Formation (*1994 version*) and Section 2: Authority of Agents (*new*); Chapter 3: Validity (*1994 version*); Chapter 4: Interpretation: (*1994 version*), Chapter 5, Section 1: Content (*1994 version, with the addition of Article 5.1.9*) and Section 2: Third Party Rights (*new*); Chapter 6, Section 1: Performance in General (*1994 version*) and Section 2: Hardship (*1994 version*); Chapter 7, Section 1: Non-performance in General (*1994 version*), Section 2: Right to Performance (*1994 version*), Section 3: Termination (*1994 version*) and Section 4: Damages (*1994 version*); Chapter 8: Set-off (*new*); Chapter 9, Section 1: Assignment of Rights (*new*), Section 2: Transfer of Obligations (*new*) and Section 3: Assignment of Contracts (*new*); Chapter 10: Limitation Periods (*new*).

In presenting the first edition of the UNIDROIT Principles the Governing Council expressed its confidence that the international legal and business communities to which the UNIDROIT Principles were addressed would appreciate their merits and benefit from their use. The success in practice of the UNIDROIT Principles over the last ten years has surpassed the most optimistic expectations. It is hoped that the 2004 edition of the UNIDROIT Principles will be just as favourably received by legislators, business persons, lawyers, arbitrators and judges and become even better known and more widely used throughout the world.

THE GOVERNING COUNCIL OF UNIDROIT

Rome, April 2004

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Secretaries to the Working Group were Paula HOWARTH and Lena PETERS of the UNIDROIT Secretariat



## FOREWORD TO THE 1994 EDITION

*It is with the utmost pleasure that the International Institute for the Unification of Private Law (UNIDROIT) announces the completion of the drawing up of the UNIDROIT Principles of International Commercial Contracts. This achievement represents the outcome of many years of intensive research and deliberations involving the participation of a large number of eminent lawyers from all five continents of the world.*

*Tribute must first be paid to the members of the Working Group primarily entrusted with the preparation of the UNIDROIT Principles and, among them, especially to the Rapporteurs for the different chapters. Without their personal commitment and unstinting efforts, so ably coordinated throughout by Michael Joachim Bonell, this ambitious project could not have been brought to its successful conclusion.*

*We must also express gratitude for the most valuable input given by the numerous practising lawyers, judges, civil servants and academics from widely differing legal cultures and professional backgrounds, who became involved in the project at various stages of the drafting process and whose constructive criticism was of the greatest assistance.*

*In this moment of great satisfaction for the Institute we cannot but evoke the memory of Mario Matteucci, who for so many years served UNIDROIT as Secretary-General and then as President and whose belief in the Principles as a vital contribution to the process of international unification of law was a source of constant inspiration to us all.*

*Malcolm Evans  
Secretary-General*

*Riccardo Monaco  
President*

## INTRODUCTION TO THE 1994 EDITION

Efforts towards the international unification of law have hitherto essentially taken the form of binding instruments, such as supranational legislation or international conventions, or of model laws. Since these instruments often risk remaining little more than a dead letter and tend to be rather fragmentary in character, calls are increasingly being made for recourse to non-legislative means of unification or harmonisation of law.

Some of those calls are for the further development of what is termed “international commercial custom”, for example through model clauses and contracts formulated by the interested business circles on the basis of current trade practices and relating to specific types of transactions or particular aspects thereof.

Others go even further and advocate the elaboration of an international restatement of general principles of contract law.

UNIDROIT’s initiative for the elaboration of “Principles of International Commercial Contracts” goes in that direction.

It was as long ago as 1971 that the Governing Council decided to include this subject in the Work Programme of the Institute. A small Steering Committee, composed of Professors René David, Clive M. Schmitthoff and Tudor Popescu, representing the civil law, the common law and the socialist systems, was set up with the task of conducting preliminary inquiries into the feasibility of such a project.

It was not until 1980, however, that a special Working Group was constituted for the purpose of preparing the various draft chapters of the Principles. The Group, which included representatives of all the major legal systems of the world, was composed of leading experts in the field of contract law and international trade law. Most of them were academics, some high ranking judges or civil servants, who all sat in a personal capacity.

The Group appointed from among its members Rapporteurs for the different chapters of the UNIDROIT Principles, who were entrusted with the task of submitting successive drafts together with Comments. These were then discussed by the Group and circulated to a wide range of experts, including UNIDROIT’s extensive network of correspondents. In addition, the Governing Council offered its advice on the policy to be followed, especially in those cases where the Group had found it difficult to reach a consensus. The necessary editorial work was entrusted to an Editorial Committee, assisted by the Secretariat.

## UNIDROIT Principles

For the most part the UNIDROIT Principles reflect concepts to be found in many, if not all, legal systems. Since however the UNIDROIT Principles are intended to provide a system of rules especially tailored to the needs of international commercial transactions, they also embody what are perceived to be the best solutions, even if still not yet generally adopted.

The objective of the UNIDROIT Principles is to establish a balanced set of rules designed for use throughout the world irrespective of the legal traditions and the economic and political conditions of the countries in which they are to be applied. This goal is reflected both in their formal presentation and in the general policy underlying them.

As to their formal presentation, the UNIDROIT Principles deliberately seek to avoid the use of terminology peculiar to any given legal system. The international character of the UNIDROIT Principles is also stressed by the fact that the comments accompanying each single provision systematically refrain from referring to national laws in order to explain the origin and rationale of the solution retained. Only where the rule has been taken over more or less literally from the world wide accepted United Nations Convention on Contracts for the International Sale of Goods (CISG) is explicit reference made to its source.

With regard to substance, the UNIDROIT Principles are sufficiently flexible to take account of the constantly changing circumstances brought about by the technological and economic developments affecting cross-border trade practice. At the same time they attempt to ensure fairness in international commercial relations by expressly stating the general duty of the parties to act in accordance with good faith and fair dealing and, in a number of specific instances, imposing standards of reasonable behaviour.

Naturally, to the extent that the UNIDROIT Principles address issues also covered by CISG, they follow the solutions found in that Convention, with such adaptations as were considered appropriate to reflect the particular nature and scope of the Principles <sup>(\*)</sup>.

In offering the UNIDROIT Principles to the international legal and business communities, the Governing Council is fully conscious of the fact that the UNIDROIT Principles, which do not involve the endorsement of Governments, are not a binding instrument and that in consequence their acceptance will depend upon their persuasive authority. There are a number of significant ways in which the UNIDROIT Principles may

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<sup>(\*)</sup> See especially Arts. 1.8, 1.9, 2.2, in conjunction with Arts. 5.7 and 7.2.2.

## **Introduction (1994)**

find practical application, the most important of which are amply explained in the Preamble.

The Governing Council is confident that those to whom the UNIDROIT Principles are addressed will appreciate their intrinsic merits and derive full advantage from their use.

## **THE GOVERNING COUNCIL OF UNIDROIT**

Rome, May 1994

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THE UNIDROIT PRINCIPLES (1994)**

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## UNIDROIT Principles

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## Table of correspondence of the articles of the 1994, 2004 and 2010 editions of the UNIDROIT Principles

*[Note that (\*) indicates that both the black letter rule and the comments have been, at least in part, amended with respect to the previous edition, while (\*\*) indicates that only the comments have been amended with respect to the previous edition.]*

2010 edition	2004 edition	1994 edition
<i>Preamble</i>	<i>Preamble (*)</i>	<i>Preamble</i>
1.1	1.1	1.1
1.2	1.2 (*)	1.2
1.3	1.3 (**)	1.3
1.4 (**)	1.4	1.4
1.5	1.5	1.5
1.6	1.6	1.6
1.7 (**)	1.7 (**)	1.7
1.8	1.8	–
1.9	1.9	1.8
1.10	1.10 (**)	1.9
1.11	1.11	1.10
1.12	1.12 (*)	2.8 (2)
2.1.1	2.1.1 (**)	2.1
2.1.2	2.1.2	2.2
2.1.3	2.1.3	2.3
2.1.4	2.1.4	2.4
2.1.5	2.1.5	2.5
2.1.6	2.1.6	2.6
2.1.7	2.1.7 (**)	2.7
2.1.8	2.1.8 (*)	2.8 (1)
2.1.9	2.1.9	2.9
2.1.10	2.1.10	2.10
2.1.11	2.1.11	2.11
2.1.12	2.1.12	2.12
2.1.13	2.1.13	2.13
2.1.14	2.1.14	2.14

## UNIDROIT Principles

2010 edition	2004 edition	1994 edition
2.1.15	2.1.15 (**)	2.15
2.1.16	2.1.16	2.16
2.1.17	2.1.17	2.17
2.1.18	2.1.18 (*)	2.18
2.1.19	2.1.19	2.19
2.1.20	2.1.20	2.20
2.1.21	2.1.21	2.21
2.1.22	2.1.22	2.22
2.2.1	2.2.1	—
2.2.2	2.2.2	—
2.2.3	2.2.3	—
2.2.4	2.2.4	—
2.2.5	2.2.5	—
2.2.6	2.2.6	—
2.2.7	2.2.7	—
2.2.8	2.2.8	—
2.2.9	2.2.9	—
2.2.10	2.2.10	—
3.1.1 (*)	3.1	3.1
3.1.2	3.2	3.2
3.1.3	3.3	3.3
3.1.4 (*)	3.19	3.19
3.2.1	3.4	3.4
3.2.2	3.5	3.5
3.2.3	3.6	3.6
3.2.4	3.7	3.7
3.2.5	3.8	3.8
3.2.6	3.9	3.9
3.2.7	3.10	3.10
3.2.8	3.11	3.11
3.2.9	3.12	3.12
3.2.10	3.13	3.13
3.2.11	3.14	3.14
3.2.12	3.15	3.15
3.2.13	3.16	3.16

## Table of Correspondence

2010 edition	2004 edition	1994 edition
3.2.14	3.17 (1)	3.17 (1)
3.2.15 (*)	3.17 (2)	3.17 (2)
3.2.16	3.18	3.18
3.2.17	3.20	3.20
3.3.1	—	—
3.3.2	—	—
4.1	4.1	4.1
4.2	4.2	4.2
4.3	4.3	4.3
4.4	4.4	4.4
4.5	4.5	4.5
4.6	4.6	4.6
4.7	4.7	4.7
4.8	4.8	4.8
5.1.1	5.1.1	5.1
5.1.2	5.1.2	5.2
5.1.3	5.1.3	5.3
5.1.4	5.1.4	5.4
5.1.5	5.1.5	5.5
5.1.6	5.1.6	5.6
5.1.7	5.1.7	5.7
5.1.8	5.1.8	5.8
5.1.9	5.1.9	—
5.2.1	5.2.1	—
5.2.2	5.2.2	—
5.2.3	5.2.3	—
5.2.4	5.2.4	—
5.2.5	5.2.5	—
5.2.6	5.2.6	—
5.3.1	—	—
5.3.2	—	—
5.3.3	—	—
5.3.4	—	—
5.3.5	—	—
6.1.1	6.1.1	6.1.1
6.1.2	6.1.2	6.1.2



## UNIDROIT Principles

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2010 edition	2004 edition	1994 edition
6.1.3	6.1.3	6.1.3
6.1.4	6.1.4	6.1.4
6.1.5	6.1.5	6.1.5
6.1.6	6.1.6	6.1.6
6.1.7	6.1.7	6.1.7
6.1.8	6.1.8	6.1.8
6.1.9	6.1.9	6.1.9
6.1.10	6.1.10	6.1.10
6.1.11	6.1.11	6.1.11
6.1.12	6.1.12	6.1.12
6.1.13	6.1.13	6.1.13
6.1.14	6.1.14	6.1.14
6.1.15	6.1.15	6.1.15
6.1.16	6.1.16	6.1.16
6.1.17	6.1.17	6.1.17
6.2.1	6.2.1	6.2.1
6.2.2	6.2.2 (**)	6.2.2
6.2.3	6.2.3	6.2.3
7.1.1	7.1.1	7.1.1
7.1.2	7.1.2	7.1.2
7.1.3	7.1.3	7.1.3
7.1.4	7.1.4	7.1.4
7.1.5	7.1.5	7.1.5
7.1.6	7.1.6	7.1.6
7.1.7	7.1.7	7.1.7
7.2.1	7.2.1	7.2.1
7.2.2	7.2.2	7.2.2
7.2.3	7.2.3	7.2.3
7.2.4	7.2.4	7.2.4
7.2.5	7.2.5	7.2.5
7.3.1	7.3.1	7.3.1
7.3.2	7.3.2	7.3.2
7.3.3	7.3.3	7.3.3
7.3.4	7.3.4	7.3.4
7.3.5	7.3.5	7.3.5

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## Table of Correspondence

2010 edition	2004 edition	1994 edition
7.3.6 (*)	7.3.6 (1)	7.3.6 (1)
7.3.7 (*)	7.3.6 (2)	7.3.6 (2)
7.4.1	7.4.1	7.4.1
7.4.2	7.4.2	7.4.2
7.4.3	7.4.3	7.4.3
7.4.4	7.4.4	7.4.4
7.4.5	7.4.5	7.4.5
7.4.6	7.4.6	7.4.6
7.4.7	7.4.7	7.4.7
7.4.8	7.4.8	7.4.8
7.4.9	7.4.9	7.4.9
7.4.10	7.4.10	7.4.10
7.4.11	7.4.11	7.4.11
7.4.12	7.4.12	7.4.12
7.4.13	7.4.13	7.4.13
8.1	8.1	—
8.2	8.2	—
8.3	8.3	—
8.4	8.4	—
8.5	8.5	—
9.1.1	9.1.1	—
9.1.2	9.1.2	—
9.1.3	9.1.3	—
9.1.4	9.1.4	—
9.1.5	9.1.5	—
9.1.6	9.1.6	—
9.1.7	9.1.7	—
9.1.8	9.1.8	—
9.1.9	9.1.9	—
9.1.10	9.1.10	—
9.1.11	9.1.11	—
9.1.12	9.1.12	—
9.1.13	9.1.13	—
9.1.14	9.1.14	—
9.1.15	9.1.15	—

## UNIDROIT Principles

2010 edition	2004 edition	1994 edition
9.2.1	9.2.1	—
9.2.2	9.2.2	—
9.2.3	9.2.3	—
9.2.4	9.2.4	—
9.2.5	9.2.5	—
9.2.6	9.2.6	—
9.2.7	9.2.7	—
9.2.8	9.2.8	—
9.3.1	9.3.1	—
9.3.2	9.3.2	—
9.3.3	9.3.3	—
9.3.4	9.3.4	—
9.3.5	9.3.5	—
9.3.6	9.3.6	—
9.3.7	9.3.7	—
10.1	10.1	—
10.2	10.2	—
10.3	10.3	—
10.4	10.4	—
10.5	10.5	—
10.6	10.6	—
10.7	10.7	—
10.8	10.8	—
10.9	10.9	—
10.10	10.10	—
10.11	10.11	—
11.1.1	—	—
11.1.2	—	—
11.1.3	—	—
11.1.4	—	—
11.1.5	—	—
11.1.6	—	—
11.1.7	—	—
11.1.8	—	—
11.1.9	—	—
11.1.10	—	—

## Table of Correspondence

2010 edition	2004 edition	1994 edition
11.1.11	—	—
11.1.12	—	—
11.1.13	—	—
11.2.1	—	—
11.2.2	—	—
11.2.3	—	—
11.2.4	—	—



# CONTENTS

<i>Foreword to the 2010 edition</i>	v
Introduction to the 2010 edition	vii
The UNIDROIT Governing Council (2009-2013)	ix
Members of the Working Group (2010)	x
<i>Foreword to the 2004 edition</i>	xv
Introduction to the 2004 edition	xvi
The UNIDROIT Governing Council (1999-2004)	xviii
Members of the Working Group (2004)	xix
<i>Foreword to the 1994 edition</i>	xxi
Introduction to the 1994 edition	xxii
The UNIDROIT Governing Council (1994-1998)	xxv
Members of the Working Group (1994)	xxvi
Table of correspondence of the articles of the 1994, 2004 and 2010 editions of the UNIDROIT Principles	xxxii

<b>PREAMBLE</b> <i>(Purpose of the Principles)</i>	1
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## **CHAPTER 1: GENERAL PROVISIONS**

Article 1.1	<i>(Freedom of contract)</i>	8
Article 1.2	<i>(No form required)</i>	9
Article 1.3	<i>(Binding character of contract)</i>	10
Article 1.4	<i>(Mandatory rules)</i>	12
Article 1.5	<i>(Exclusion or modification by the parties)</i>	14
Article 1.6	<i>(Interpretation and supplementation of the Principles)</i>	16
Article 1.7	<i>(Good faith and fair dealing)</i>	18
Article 1.8	<i>(Inconsistent behaviour)</i>	22
Article 1.9	<i>(Usages and practices)</i>	25
Article 1.10	<i>(Notice)</i>	28
Article 1.11	<i>(Definitions)</i>	30
Article 1.12	<i>(Computation of time set by parties)</i>	32

## **CHAPTER 2: FORMATION AND AUTHORITY OF AGENTS**

### **Section 1: Formation**

Article 2.1.1	<i>(Manner of formation)</i>	35
Article 2.1.2	<i>(Definition of offer)</i>	36
Article 2.1.3	<i>(Withdrawal of offer)</i>	38
Article 2.1.4	<i>(Revocation of offer)</i>	39
Article 2.1.5	<i>(Rejection of offer)</i>	42

## UNIDROIT Principles

Article 2.1.6	<i>(Mode of acceptance)</i>	43
Article 2.1.7	<i>(Time of acceptance)</i>	46
Article 2.1.8	<i>(Acceptance within a fixed period of time)</i>	47
Article 2.1.9	<i>(Late acceptance. Delay in transmission)</i>	48
Article 2.1.10	<i>(Withdrawal of acceptance)</i>	50
Article 2.1.11	<i>(Modified acceptance)</i>	50
Article 2.1.12	<i>(Writings in confirmation)</i>	52
Article 2.1.13	<i>(Conclusion of contract dependent on agreement on specific matters or in a particular form)</i>	54
Article 2.1.14	<i>(Contract with terms deliberately left open)</i>	56
Article 2.1.15	<i>(Negotiations in bad faith)</i>	59
Article 2.1.16	<i>(Duty of confidentiality)</i>	62
Article 2.1.17	<i>(Merger clauses)</i>	64
Article 2.1.18	<i>(Modification in a particular form)</i>	64
Article 2.1.19	<i>(Contracting under standard terms)</i>	66
Article 2.1.20	<i>(Surprising terms)</i>	68
Article 2.1.21	<i>(Conflict between standard terms and non-standard terms)</i>	70
Article 2.1.22	<i>(Battle of forms)</i>	71
<b>Section 2: Authority of agents</b>		
Article 2.2.1	<i>(Scope of the Section)</i>	74
Article 2.2.2	<i>(Establishment and scope of the authority of the agent)</i>	77
Article 2.2.3	<i>(Agency disclosed)</i>	78
Article 2.2.4	<i>(Agency undisclosed)</i>	81
Article 2.2.5	<i>(Agent acting without or exceeding its authority)</i>	82
Article 2.2.6	<i>(Liability of agent acting without or exceeding its authority)</i>	84
Article 2.2.7	<i>(Conflict of interests)</i>	86
Article 2.2.8	<i>(Sub-agency)</i>	88
Article 2.2.9	<i>(Ratification)</i>	90
Article 2.2.10	<i>(Termination of authority)</i>	92

## CHAPTER 3: VALIDITY

### Section 1: General Provisions

Article 3.1.1	<i>(Matters not covered)</i>	94
Article 3.1.2	<i>(Validity of mere agreement)</i>	94
Article 3.1.3	<i>(Initial impossibility)</i>	96
Article 3.1.4	<i>(Mandatory character of the provisions)</i>	98

## Contents

<b>Section 2:</b>	<b>Grounds for avoidance</b>	
Article 3.2.1	<i>(Definition of mistake)</i>	99
Article 3.2.2	<i>(Relevant mistake)</i>	100
Article 3.2.3	<i>(Error in expression or transmission)</i>	103
Article 3.2.4	<i>(Remedies for non-performance)</i>	104
Article 3.2.5	<i>(Fraud)</i>	105
Article 3.2.6	<i>(Threat)</i>	106
Article 3.2.7	<i>(Gross disparity)</i>	108
Article 3.2.8	<i>(Third persons)</i>	110
Article 3.2.9	<i>(Confirmation)</i>	112
Article 3.2.10	<i>(Loss of right to avoid)</i>	112
Article 3.2.11	<i>(Notice of avoidance)</i>	114
Article 3.2.12	<i>(Time limits)</i>	115
Article 3.2.13	<i>(Partial avoidance)</i>	115
Article 3.2.14	<i>(Retroactive effect of avoidance)</i>	116
Article 3.2.15	<i>(Restitution)</i>	117
Article 3.2.16	<i>(Damages)</i>	121
Article 3.2.17	<i>(Unilateral declarations)</i>	122
<b>Section 3:</b>	<b>Illegality</b>	
Article 3.3.1	<i>(Contracts infringing mandatory rules)</i>	124
Article 3.3.2	<i>(Restitution)</i>	134
 <b>CHAPTER 4: INTERPRETATION</b>		
Article 4.1	<i>(Intention of the parties)</i>	137
Article 4.2	<i>(Interpretation of statements and other conduct)</i>	138
Article 4.3	<i>(Relevant circumstances)</i>	140
Article 4.4	<i>(Reference to contract or statement as a whole)</i>	142
Article 4.5	<i>(All terms to be given effect)</i>	143
Article 4.6	<i>(Contra proferentem rule)</i>	144
Article 4.7	<i>(Linguistic discrepancies)</i>	145
Article 4.8	<i>(Supplying an omitted term)</i>	146
 <b>CHAPTER 5: CONTENT, THIRD PARTY RIGHTS AND CONDITIONS</b>		
<b>Section 1:</b>	<b>Content</b>	
Article 5.1.1	<i>(Express and implied obligations)</i>	148
Article 5.1.2	<i>(Implied obligations)</i>	148
Article 5.1.3	<i>(Co-operation between the parties)</i>	149
Article 5.1.4	<i>(Duty to achieve a specific result. Duty of best efforts)</i>	150
Article 5.1.5	<i>(Determination of kind of duty involved)</i>	152
Article 5.1.6	<i>(Determination of quality of performance)</i>	154



## UNIDROIT Principles

Article 5.1.7	<i>(Price determination)</i>	156
Article 5.1.8	<i>(Contract for an indefinite period)</i>	159
Article 5.1.9	<i>(Release by agreement)</i>	160
<b>Section 2:</b>	<b>Third party rights</b>	
Article 5.2.1	<i>(Contracts in favour of third parties)</i>	161
Article 5.2.2	<i>(Third party identifiable)</i>	163
Article 5.2.3	<i>(Exclusion and limitation clauses)</i>	164
Article 5.2.4	<i>(Defences)</i>	165
Article 5.2.5	<i>(Revocation)</i>	166
Article 5.2.6	<i>(Renunciation)</i>	167
<b>Section 3:</b>	<b>Conditions</b>	
Article 5.3.1	<i>(Types of condition)</i>	168
Article 5.3.2	<i>(Effect of conditions)</i>	173
Article 5.3.3	<i>(Interference with conditions)</i>	174
Article 5.3.4	<i>(Duty to preserve rights)</i>	176
Article 5.3.5	<i>(Restitution in case of fulfilment of a resolutive condition)</i>	177
 <b>CHAPTER 6: PERFORMANCE</b>		
<b>Section 1:</b>	<b>Performance in General</b>	
Article 6.1.1	<i>(Time of performance)</i>	179
Article 6.1.2	<i>(Performance at one time or in instalments)</i>	180
Article 6.1.3	<i>(Partial performance)</i>	181
Article 6.1.4	<i>(Order of performance)</i>	183
Article 6.1.5	<i>(Earlier performance)</i>	185
Article 6.1.6	<i>(Place of performance)</i>	188
Article 6.1.7	<i>(Payment by cheque or other instrument)</i>	190
Article 6.1.8	<i>(Payment by funds transfer)</i>	191
Article 6.1.9	<i>(Currency of payment)</i>	193
Article 6.1.10	<i>(Currency not expressed)</i>	196
Article 6.1.11	<i>(Costs of performance)</i>	197
Article 6.1.12	<i>(Imputation of payments)</i>	198
Article 6.1.13	<i>(Imputation of non-monetary obligations)</i>	199
Article 6.1.14	<i>(Application for public permission)</i>	200
Article 6.1.15	<i>(Procedure in applying for permission)</i>	204
Article 6.1.16	<i>(Permission neither granted nor refused)</i>	207
Article 6.1.17	<i>(Permission refused)</i>	209
<b>Section 2:</b>	<b>Hardship</b>	
Article 6.2.1	<i>(Contract to be observed)</i>	212
Article 6.2.2	<i>(Definition of hardship)</i>	213
Article 6.2.3	<i>(Effects of hardship)</i>	218

## Contents

### CHAPTER 7: NON-PERFORMANCE

#### Section 1: Non-performance in general

Article 7.1.1	<i>(Non-performance defined)</i>	223
Article 7.1.2	<i>(Interference by the other party)</i>	224
Article 7.1.3	<i>(Withholding performance)</i>	225
Article 7.1.4	<i>(Cure by non-performing party)</i>	226
Article 7.1.5	<i>(Additional period for performance)</i>	230
Article 7.1.6	<i>(Exemption clauses)</i>	233
Article 7.1.7	<i>(Force majeure)</i>	236

#### Section 2: Right to performance

Article 7.2.1	<i>(Performance of monetary obligation)</i>	239
Article 7.2.2	<i>(Performance of non-monetary obligation)</i>	239
Article 7.2.3	<i>(Repair and replacement of defective performance)</i>	243
Article 7.2.4	<i>(Judicial penalty)</i>	245
Article 7.2.5	<i>(Change of remedy)</i>	247

#### Section 3: Termination

Article 7.3.1	<i>(Right to terminate the contract)</i>	249
Article 7.3.2	<i>(Notice of termination)</i>	252
Article 7.3.3	<i>(Anticipatory non-performance)</i>	254
Article 7.3.4	<i>(Adequate assurance of due performance)</i>	255
Article 7.3.5	<i>(Effects of termination in general)</i>	256
Article 7.3.6	<i>(Restitution with respect to contracts to be performed at one time)</i>	257
Article 7.3.7	<i>(Restitution with respect to contracts to be performed over a period of time)</i>	263

#### Section 4: Damages

Article 7.4.1	<i>(Right to damages)</i>	265
Article 7.4.2	<i>(Full compensation)</i>	266
Article 7.4.3	<i>(Certainty of harm)</i>	269
Article 7.4.4	<i>(Foreseeability of harm)</i>	271
Article 7.4.5	<i>(Proof of harm in case of replacement transaction)</i>	272
Article 7.4.6	<i>(Proof of harm by current price)</i>	274
Article 7.4.7	<i>(Harm due in part to aggrieved party)</i>	275
Article 7.4.8	<i>(Mitigation of harm)</i>	277
Article 7.4.9	<i>(Interest for failure to pay money)</i>	279
Article 7.4.10	<i>(Interest on damages)</i>	281
Article 7.4.11	<i>(Manner of monetary redress)</i>	282
Article 7.4.12	<i>(Currency in which to assess damages)</i>	283
Article 7.4.13	<i>(Agreed payment for non-performance)</i>	284

## UNIDROIT Principles

### CHAPTER 8: SET-OFF

Article 8.1	<i>(Conditions of set-off)</i>	287
Article 8.2	<i>(Foreign currency set-off)</i>	293
Article 8.3	<i>(Set-off by notice)</i>	294
Article 8.4	<i>(Content of notice)</i>	294
Article 8.5	<i>(Effect of set-off)</i>	296

### CHAPTER 9: ASSIGNMENT OF RIGHTS, TRANSFER OF OBLIGATIONS, ASSIGNMENT OF CONTRACTS

#### Section 1: Assignment of rights

Article 9.1.1	<i>(Definitions)</i>	298
Article 9.1.2	<i>(Exclusions)</i>	299
Article 9.1.3	<i>(Assignability of non-monetary rights)</i>	301
Article 9.1.4	<i>(Partial assignment)</i>	302
Article 9.1.5	<i>(Future rights)</i>	303
Article 9.1.6	<i>(Rights assigned without individual specification)</i>	304
Article 9.1.7	<i>(Agreement between assignor and assignee sufficient)</i>	305
Article 9.1.8	<i>(Obligor's additional costs)</i>	307
Article 9.1.9	<i>(Non-assignment clauses)</i>	308
Article 9.1.10	<i>(Notice to the obligor)</i>	311
Article 9.1.11	<i>(Successive assignments)</i>	313
Article 9.1.12	<i>(Adequate proof of assignment)</i>	314
Article 9.1.13	<i>(Defences and rights of set-off)</i>	315
Article 9.1.14	<i>(Rights related to the right assigned)</i>	316
Article 9.1.15	<i>(Undertakings of the assignor)</i>	318

#### Section 2: Transfer of obligations

Article 9.2.1	<i>(Modes of transfer)</i>	322
Article 9.2.2	<i>(Exclusion)</i>	324
Article 9.2.3	<i>(Requirement of obligee's consent to transfer)</i>	324
Article 9.2.4	<i>(Advance consent of obligee)</i>	326
Article 9.2.5	<i>(Discharge of original obligor)</i>	327
Article 9.2.6	<i>(Third party performance)</i>	330
Article 9.2.7	<i>(Defences and rights of set-off)</i>	331
Article 9.2.8	<i>(Rights related to the obligation transferred)</i>	332

#### Section 3: Assignment of contracts

Article 9.3.1	<i>(Definitions)</i>	335
Article 9.3.2	<i>(Exclusion)</i>	335
Article 9.3.3	<i>(Requirement of consent of the other party)</i>	336
Article 9.3.4	<i>(Advance consent of the other party)</i>	337
Article 9.3.5	<i>(Discharge of the assignor)</i>	338
Article 9.3.6	<i>(Defences and rights of set-off)</i>	341
Article 9.3.7	<i>(Rights transferred with the contract)</i>	342

## Contents

### CHAPTER 10: LIMITATION PERIODS

Article 10.1	<i>(Scope of the Chapter)</i>	344
Article 10.2	<i>(Limitation periods)</i>	346
Article 10.3	<i>(Modification of limitation periods by the parties)</i>	351
Article 10.4	<i>(New limitation period by acknowledgement)</i>	353
Article 10.5	<i>(Suspension by judicial proceedings)</i>	356
Article 10.6	<i>(Suspension by arbitral proceedings)</i>	358
Article 10.7	<i>(Alternative dispute resolution)</i>	360
Article 10.8	<i>(Suspension in case of force majeure, death or incapacity)</i>	361
Article 10.9	<i>(Effects of expiration of limitation period)</i>	363
Article 10.10	<i>(Right of set-off)</i>	364
Article 10.11	<i>(Restitution)</i>	365

### CHAPTER 11: PLURALITY OF OBLIGORS AND OF OBLIGEEES

#### Section 1: Plurality of obligors

Article 11.1.1	<i>(Definitions)</i>	367
Article 11.1.2	<i>(Presumption of joint and several obligations)</i>	369
Article 11.1.3	<i>(Obligee's rights against joint and several obligors)</i>	371
Article 11.1.4	<i>(Availability of defences and rights of set-off)</i>	372
Article 11.1.5	<i>(Effect of performance or set-off)</i>	373
Article 11.1.6	<i>(Effect of release or settlement)</i>	375
Article 11.1.7	<i>(Effect of expiration or suspension of limitation period)</i>	377
Article 11.1.8	<i>(Effect of judgment)</i>	379
Article 11.1.9	<i>(Apportionment among joint and several obligors)</i>	381
Article 11.1.10	<i>(Extent of contributory claim)</i>	382
Article 11.1.11	<i>(Rights of the obligee)</i>	384
Article 11.1.12	<i>(Defences in contributory claims)</i>	385
Article 11.1.13	<i>(Inability to recover)</i>	387

#### Section 2: Plurality of obligees

Article 11.2.1	<i>(Definitions)</i>	389
Article 11.2.2	<i>(Effects of joint and several claims)</i>	393
Article 11.2.3	<i>(Availability of defences against joint and several obligees)</i>	395
Article 11.2.4	<i>(Allocation between joint and several obligees)</i>	399

<b>Annex:</b>	Text of the Articles of the Principles of International Commercial Contracts	401
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<b>Index</b>		437
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## **PREAMBLE**

*(Purpose of the Principles)*

**These Principles set forth general rules for international commercial contracts.**

**They shall be applied when the parties have agreed that their contract be governed by them.<sup>(\*)</sup>**

**They may be applied when the parties have agreed that their contract be governed by general principles of law, the *lex mercatoria* or the like.**

**They may be applied when the parties have not chosen any law to govern their contract.**

**They may be used to interpret or supplement international uniform law instruments.**

**They may be used to interpret or supplement domestic law.**

**They may serve as a model for national and international legislators.**

### **COMMENT**

The Principles set forth general rules which are basically conceived for “international commercial contracts”.

#### **1. “International” contracts**

The international character of a contract may be defined in a great variety of ways. The solutions adopted in both national and international legislation range from a reference to the place of business or habitual residence of the parties in different countries to the adoption of more general criteria such as the contract having “significant connections with

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<sup>(\*)</sup> Parties wishing to provide that their agreement be governed by the Principles might use the following words, adding any desired exceptions or modifications:

**“This contract shall be governed by the UNIDROIT Principles (2010) [except as to Articles ...]”.**

Parties wishing to provide in addition for the application of the law of a particular jurisdiction might use the following words:

**“This contract shall be governed by the UNIDROIT Principles (2010) [except as to Articles...], supplemented when necessary by the law of [jurisdiction X]”.**

## UNIDROIT Principles

more than one State”, “involving a choice between the laws of different States”, or “affecting the interests of international trade”.

The Principles do not expressly lay down any of these criteria. The assumption, however, is that the concept of “international” contracts should be given the broadest possible interpretation, so as ultimately to exclude only those situations where no international element at all is involved, i.e. where all the relevant elements of the contract in question are connected with one country only.

### 2. “Commercial” contracts

The restriction to “commercial” contracts is in no way intended to take over the distinction traditionally made in some legal systems between “civil” and “commercial” parties and/or transactions, i.e. to make the application of the Principles dependent on whether the parties have the formal status of “merchants” (*commerçants*, *Kaufleute*) and/or the transaction is commercial in nature. The idea is rather that of excluding from the scope of the Principles so-called “consumer transactions” which are within the various legal systems being increasingly subjected to special rules, mostly of a mandatory character, aimed at protecting the consumer, i.e. a party who enters into the contract otherwise than in the course of its trade or profession.

The criteria adopted at both national and international level also vary with respect to the distinction between consumer and non-consumer contracts. The Principles do not provide any express definition, but the assumption is that the concept of “commercial” contracts should be understood in the broadest possible sense, so as to include not only trade transactions for the supply or exchange of goods or services, but also other types of economic transactions, such as investment and/or concession agreements, contracts for professional services, etc.

### 3. The Principles and domestic contracts between private persons

Notwithstanding the fact that the Principles are conceived for international commercial contracts, there is nothing to prevent private persons from agreeing to apply the Principles to a purely domestic contract. Any such agreement would however be subject to the mandatory rules of the domestic law governing the contract.

## Preamble

### 4. The Principles as rules of law governing the contract

#### a. *Express choice by the parties*

As the Principles represent a system of principles and rules of contract law which are common to existing national legal systems or best adapted to the special requirements of international commercial transactions, there might be good reasons for the parties to choose them expressly as the rules of law governing their contract. In so doing the parties may refer to the Principles exclusively or in conjunction with a particular domestic law which should apply to issues not covered by the Principles (see the Model Clause in the footnote to the second paragraph of the Preamble).

Parties who wish to choose the Principles as the rules of law governing their contract are well advised to combine such a choice of law clause with an arbitration agreement.

The reason for this is that the freedom of choice of the parties in designating the law governing their contract is traditionally limited to national laws. Therefore, a reference by the parties to the Principles will normally be considered to be a mere agreement to incorporate them in the contract, while the law governing the contract will still have to be determined on the basis of the private international law rules of the forum. As a result, the Principles will bind the parties only to the extent that they do not affect the rules of the applicable law from which the parties may not derogate (see Comment 3 on Article 1.4).

The situation is different if the parties agree to submit disputes arising from their contract to arbitration. Arbitrators are not necessarily bound by a particular domestic law. This is self-evident if they are authorised by the parties to act as *amiable compositeurs* or *ex aequo et bono*. But even in the absence of such an authorisation parties are generally permitted to choose “rules of law” other than national laws on which the arbitrators are to base their decisions (see in particular Article 28(1) of the 1985 *UNCITRAL Model Law on International Commercial Arbitration*; see also Article 42(1) of the 1965 *Convention on the Settlement of Investment Disputes between States and Nationals of other States (ICSID Convention)*).

In line with this approach, the parties would be free to choose the Principles as the “rules of law” according to which the arbitrators would decide the dispute, with the result that the Principles would apply to the exclusion of any particular national law, subject only to the application of those rules of domestic law which are mandatory

## UNIDROIT Principles

irrespective of which law governs the contract (see Comment 4 on Article 1.4).

In disputes falling under the ICSID Convention, the Principles might even be applicable to the exclusion of any domestic rule of law.

### **b. *The Principles applied as a manifestation of “general principles of law”, the “lex mercatoria” or the like referred to in the contract***

Parties to international commercial contracts who cannot agree on the choice of a particular domestic law as the law applicable to their contract sometimes provide that it shall be governed by the “general principles of law”, by the “usages and customs of international trade”, by the *lex mercatoria*, etc.

Hitherto, such reference by the parties to not better identified principles and rules of a supranational or transnational character has been criticised, among other grounds, because of the extreme vagueness of such concepts. In order to avoid, or at least to reduce considerably, the uncertainty accompanying the use of such rather vague concepts, it might be advisable, in order to determine their content, to have recourse to a systematic and well-defined set of rules such as the Principles.

### **c. *The Principles applied in the absence of any choice of law by the parties***

The Principles may however be applied even if the contract is silent as to the applicable law. If the parties have not chosen the law governing their contract, it has to be determined on the basis of the relevant rules of private international law. In the context of international commercial arbitration such rules are very flexible, permitting arbitral tribunals to apply “the rules of law which they determine to be appropriate” (see e.g. Article 17(1) of the *1998 Rules of Arbitration of the International Chamber of Commerce*; Article 24(1) of the *Rules of the Arbitration Institute of the Stockholm Chamber of Commerce*). Normally arbitral tribunals will apply a particular domestic law as the proper law of the contract, yet exceptionally they may resort to a-national or supra-national rules such as the Principles. This may occur when it can be inferred from the circumstances that the parties intended to exclude the application of any domestic law (e.g. where one of the parties is a State or a government agency and both parties have made it clear that neither would accept the application of the other’s domestic law or that of a third country), or when the contract presents connecting factors with



## **Preamble**

many countries none of which is predominant enough to justify the application of one domestic law to the exclusion of all the others.

### **5. The Principles as a means of interpreting and supplementing international uniform law instruments**

International uniform law instruments may give rise to questions concerning the precise meaning of their individual provisions and may present gaps.

Traditionally international uniform law has been interpreted on the basis of, and supplemented by, principles and criteria of domestic law, be it the law of the forum or that which would, according to the relevant rules of private international law, be applicable in the absence of an international uniform law.

Recently, both courts and arbitral tribunals have increasingly abandoned such a “conflictual” approach, seeking instead to interpret and supplement international uniform law by reference to autonomous and internationally uniform principles and criteria. This approach, expressly sanctioned in recent conventions (see, e.g., Art. 7 of the *1980 UN Convention on Contracts for the International Sale of Goods (CISG)*), is based on the assumption that international uniform law, even after its incorporation into the various national legal systems, only formally becomes an integrated part of the latter, whereas from a substantive point of view it does not lose its original character of a special body of law autonomously developed at international level and intended to be applied in a uniform manner throughout the world.

Until now, such autonomous principles and criteria for the interpretation and supplementing of international uniform law instruments have had to be found in each single case by the judges and arbitrators themselves on the basis of a comparative survey of the solutions adopted in the different national legal systems. The Principles could considerably facilitate their task in this respect.

### **6. The Principles as a means of interpreting and supplementing domestic law**

The Principles may also be used to interpret and supplement domestic law. In applying a particular domestic law, courts and arbitral tribunals may be faced with doubts as to the proper solution to be adopted under that law, either because different alternatives are available or because there seem to be no specific solutions at all. Especially where the dispute relates to an international commercial contract, it may be advisable to resort to the Principles as a source of

## **UNIDROIT Principles**

inspiration. By so doing the domestic law in question would be interpreted and supplemented in accordance with internationally accepted standards and/or the special needs of cross-border trade relationships.

### **7. The Principles as a model for national and international legislators**

In view of their intrinsic merits the Principles may in addition serve as a model to national and international law-makers for the drafting of legislation in the field of general contract law or with respect to special types of transaction. At a national level, the Principles may be particularly useful to those countries which lack a developed body of legal rules relating to contracts and which intend to update their law, at least with respect to foreign economic relationships, to current international standards. Not too different is the situation of those countries with a well-defined legal system, but which after the recent dramatic changes in their socio-political structure have an urgent need to rewrite their laws, in particular those relating to economic and business activities.

At an international level the Principles could become an important term of reference for the drafting of conventions and model laws.

So far the terminology used to express the same concept differs considerably from one instrument to another, with the obvious risk of misunderstandings and misinterpretations. Such inconsistencies could be avoided if the terminology of the Principles were to be adopted as an international uniform glossary.

### **8. Other possible uses of the Principles**

The list set out in the Preamble of the different ways in which the Principles may be used is not exhaustive.

Thus, the Principles may also serve as a guide for drafting contracts. In particular the Principles facilitate the identification of the issues to be addressed in the contract and provide a neutral legal terminology equally understandable by all the parties involved. Such a use of the Principles is enhanced by the fact that they are available in a large number of languages.

The Principles may also be used as a substitute for the domestic law otherwise applicable. This is the case whenever it proves impossible or extremely difficult to establish the relevant rule of that particular domestic law with respect to a specific issue, i.e. it would entail disproportionate efforts and/or costs. The reasons for this

## **Preamble**

generally lie in the special character of the legal sources of the domestic law in question and/or the cost of accessing them.

Furthermore, the Principles may be used as course material in universities and law schools, thereby promoting the teaching of contract law on a truly comparative basis.

## **CHAPTER 1**

### **GENERAL PROVISIONS**

#### **ARTICLE 1.1**

*(Freedom of contract)*

**The parties are free to enter into a contract  
and to determine its content.**

#### **COMMENT**

##### **1. Freedom of contract as a basic principle in the context of international trade**

The principle of freedom of contract is of paramount importance in the context of international trade. The right of business people to decide freely to whom they will offer their goods or services and by whom they wish to be supplied, as well as the possibility for them freely to agree on the terms of individual transactions, are the cornerstones of an open, market-oriented and competitive international economic order.

##### **2. Economic sectors where there is no competition**

There are of course a number of possible exceptions to the principle laid down in this Article.

As concerns the freedom to conclude contracts with any other person, there are economic sectors which States may decide in the public interest to exclude from open competition. In such cases the goods or services in question can only be requested from the one available supplier, which will usually be a public body, and which may or may not be under a duty to conclude a contract with whoever makes a request, within the limits of the availability of the goods or services.

##### **3. Limitation of party autonomy by mandatory rules**

With respect to the freedom to determine the content of the contract, in the first instance the Principles themselves contain provisions from which the parties may not derogate (see Article 1.5).

Moreover, there are mandatory rules, whether of national, international or supra-national origin, which, if applicable in accordance with the relevant rules of private international law, prevail over the provisions contained in the Principles and from which the parties cannot derogate (see Article 1.4).

## ARTICLE 1.2

*(No form required)*

**Nothing in these Principles requires a contract, statement or any other act to be made in or evidenced by a particular form. It may be proved by any means, including witnesses.**

### COMMENT

#### 1. Contracts as a rule not subject to formal requirements

This Article states the principle that the conclusion of a contract is not subject to any requirement as to form. The same principle also applies to the subsequent modification or termination of a contract by agreement of the parties.

The principle, which is to be found in many, although not in all, legal systems, seems particularly appropriate in the context of international trade relationships where, thanks to modern means of communication, many transactions are concluded at great speed and by a mixture of conversations, telefaxes, paper contracts, e-mail and web communication.

The first sentence of the Article takes into account the fact that some legal systems regard requirements as to form as matters relating to substance, while others impose them for evidentiary purposes only. The second sentence is intended to make it clear that to the extent that the principle of freedom of form applies, it implies the admissibility of oral evidence in judicial proceedings.

#### 2. Statements and other unilateral acts

The principle of no requirement as to form applies also to statements and other unilateral acts. The most important such acts are statements of intent made by parties either in the course of the formation or performance of a contract (e.g. an offer, acceptance of an offer, confirmation of the contract by the party entitled to avoid it,

determination of the price by one of the parties, etc.), or in other contexts (e.g. the grant of authority by a principal to an agent, the ratification by a principal of an act performed by an agent without authority, the obligor's acknowledgement of the obligee's right before the expiration of the general limitation period, etc.).

### **3. Possible exceptions under the applicable law**

The principle of no requirement as to form may of course be overridden by the applicable law (see Article 1.4). National laws as well as international instruments may impose special requirements as to form with respect either to the contract as a whole or to individual terms (e.g. arbitration agreements; choice of court agreements).

### **4. Form requirements agreed by the parties**

Moreover, the parties may themselves agree on a specific form for the conclusion, modification or termination of their contract or for any other statement they may make or unilateral act they may perform in the course of the formation or performance of their contract or in any other context. In this connection see, in particular, Articles 2.1.13, 2.1.17 and 2.1.18.

## **ARTICLE 1.3**

*(Binding character of contract)*

**A contract validly entered into is binding upon the parties. It can only be modified or terminated in accordance with its terms or by agreement or as otherwise provided in these Principles.**

**COMMENT****1. The principle *pacta sunt servanda***

This Article lays down another basic principle of contract law, that of *pacta sunt servanda*.

The binding character of a contractual agreement obviously presupposes that an agreement has actually been concluded by the parties and that the agreement reached is not affected by any ground of invalidity. The rules governing the conclusion of contractual agreements are laid down in Chapter 2 Section 1 of the Principles, while the grounds of invalidity are dealt with in Chapter 3, as well as in individual provisions in other Chapters (see, e.g., Articles 7.1.6 and 7.4.13(2)). Additional requirements for the valid conclusion of contracts may be found in the applicable national or international mandatory rules.

**2. Exceptions**

A corollary of the principle of *pacta sunt servanda* is that a contract may be modified or terminated whenever the parties so agree. Modification or termination without agreement are on the contrary the exception and can therefore be admitted only when in conformity with the terms of the contract or when expressly provided for in the Principles (see Articles 3.2.7(2), 3.2.7(3), 3.2.10, 5.1.8, 6.1.16, 6.2.3, 7.1.7, 7.3.1 and 7.3.3).

**3. Effects on third persons**

By stating the principle of the binding force of the contract between the parties, this Article does not intend to prejudice any effect which that contract may have vis-à-vis third persons under the applicable law. Thus, a seller may in some jurisdictions be under a contractual duty to protect the physical integrity and property not only of the buyer, but also of accompanying persons during their presence on the seller's premises.

Similarly the Principles do not deal with the effects of avoidance and termination of a contract on the rights of third persons.

With respect to cases where the agreement between the parties by its very nature is intended to affect the legal relations of other persons, see Section 2 of Chapter 2 on "Authority of Agents", Section 2 of Chapter 5 on "Third Party Rights", Chapter 9 on "Assignment of Rights, Transfer of Obligations, Assignment of Contracts" and Chapter 11 on "Plurality of Obligors and Obligees".

**ARTICLE 1.4***(Mandatory rules)*

**Nothing in these Principles shall restrict the application of mandatory rules, whether of national, international or supranational origin, which are applicable in accordance with the relevant rules of private international law.**

**COMMENT****1. Mandatory rules prevail**

Given the particular nature of the Principles as a non-legislative instrument, neither the Principles nor individual contracts concluded in accordance with the Principles, can be expected to prevail over mandatory rules of domestic law, whether of national, international or supranational origin, that are applicable in accordance with the relevant rules of private international law. Mandatory rules of national origin are those enacted by States autonomously (e.g. particular form requirements for specific types of contracts; invalidity of penalty clauses; licensing requirements; environmental regulations; etc.), while mandatory rules of international or supranational origin are those derived from international conventions or general public international law (e.g. *Hague-Visby Rules*; *UNIDROIT Convention on Stolen or Illegally Exported Cultural Objects*; *United Nations Convention against Corruption*; *United Nations Universal Declaration of Human Rights*, etc.) or adopted by supranational organisations (e.g. European Union competition law, etc.).

**2. Broad notion of “mandatory rules”**

The mandatory rules referred to in this Article are predominantly laid down by specific legislation, and their mandatory nature, may either be expressly stated or inferred by way of interpretation. However, in the various national legal systems restrictions on freedom of contract may also derive from general principles of public policy, whether of national, international or supranational origin (e.g. prohibition of commission or inducement of crime; prohibition of corruption and collusive bidding; protection of human dignity; prohibition of discrimination on the basis of gender, race or religion; prohibition of undue restraint of trade; etc). For the purpose of this Article the notion of “mandatory rules”



is to be understood in a broad sense, so as to cover both specific statutory provisions and general principles of public policy.

### **3. Mandatory rules applicable in case of incorporation of the Principles as terms of contract**

Where, as is the traditional and still prevailing approach adopted by domestic courts with respect to soft law instruments, the parties' reference to the Principles is considered to be merely an agreement to incorporate them in the contract (see Comment 4 lit. (a), third paragraph, to the Preamble), the Principles and the individual contracts concluded in accordance with the Principles will first of all encounter the limit of the principles and rules of the domestic law that govern the contract from which parties may not contractually derogate (so-called "ordinary" or "domestically mandatory" rules). Moreover, the mandatory rules of the forum State, and possibly of other countries, may also apply if the mandatory rules claim application irrespective of what the law governing the contract is, and, in the case of the mandatory rules of other countries, there is a sufficiently close connection between those countries and the contract in question (so-called "overriding" or "internationally mandatory" rules).

### **4. Mandatory rules applicable in case of reference to the Principles as law governing the contract**

Where, as may be the case if the dispute is brought before an arbitral tribunal, the Principles are applied as the law governing the contract (see Comment 4 lit. (a), fourth paragraph, to the Preamble), they no longer encounter the limit of the ordinary mandatory rules of any domestic law. As far as the overriding mandatory rules of the forum State or of other countries are concerned, their application basically depends on the circumstances of the case. Generally speaking, since in international arbitration the arbitral tribunal lacks a predetermined *lex fori*, it may, but is under no duty to, apply the overriding mandatory rules of the country on the territory of which it renders the award. In determining whether to take into consideration the overriding mandatory rules of the forum State or of any other country with which the case at hand has a significant connection, the arbitral tribunal, bearing in mind its task to "make every effort to make sure that the Award is enforceable at law" (so expressly e.g. Article 35 of the *1998 ICC Arbitration Rules*), may be

expected to pay particular attention to the overriding mandatory rules of those countries where enforcement of the award is likely to be sought. Moreover, the arbitral tribunal may consider it necessary to apply those overriding mandatory rules that reflect principles widely accepted as fundamental in legal systems throughout the world (so-called “transnational public policy” or “*ordre public transnational*”).

### **5. Recourse to rules of private international law relevant in each given case**

In view of the considerable differences in the ways in which domestic courts and arbitral tribunals determine the mandatory rules applicable to international commercial contracts, this Article deliberately refrains from stating which mandatory rules apply and the Article refers instead to the relevant rules of private international law for the solution in each given case (see e.g. Article 9 of *EC Regulation No. 593/2008 (Rome I)* (replacing Article 7 of the *1980 Rome Convention on the Law applicable to Contractual Obligations*); Article 11 of the *1994 Inter-American Convention on the Law Applicable to International Contracts*; Articles 28, 34 and 36 of the *UNCITRAL Model Law on International Commercial Arbitration*; and Article V of the *New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards*).

### **ARTICLE 1.5**

*(Exclusion or modification by the parties)*

**The parties may exclude the application of these Principles or derogate from or vary the effect of any of their provisions, except as otherwise provided in the Principles.**

### **COMMENT**

#### **1. The non-mandatory character of the Principles**

The rules laid down in the Principles are in general of a non-mandatory character, i.e. the parties may in each individual case either simply exclude their application in whole or in part or modify their content so as to adapt them to the specific needs of the kind of

transaction involved (see the Model Clause in the footnote to the second paragraph of the Preamble).

## **2. Exclusion or modification may be express or implied**

The exclusion or modification of the Principles by the parties may be either express or implied. There is an implied exclusion or modification when the parties expressly agree on contract terms which are inconsistent with provisions of the Principles and it is in this context irrelevant whether the terms in question have been negotiated individually or form part of standard terms incorporated by the parties in their contract.

If the parties expressly agree to the application of some only of the Chapters of the Principles (e.g. “As far as the performance and non-performance of this contract is concerned, the UNIDROIT Principles shall apply”), it is presumed that the Chapters concerned will be applied together with the general provisions of Chapter 1.

## **3. Mandatory provisions to be found in the Principles**

A few provisions of the Principles are of a mandatory character, i.e. their importance in the system of the Principles is such that parties should not be permitted to exclude or to derogate from them as they wish. It is true that given the particular nature of the Principles the non-observance of this precept may have no consequences. On the other hand, it should be noted that the provisions in question reflect principles and standards of behaviour which are of a mandatory character under most domestic laws also.

Those provisions of the Principles which are mandatory are normally expressly indicated as such. This is the case with Article 1.7 on good faith and fair dealing, with the provisions of Chapter 3 on substantive validity, except in so far as they relate or apply to mistake and to initial impossibility (see Article 3.1.4), with Article 5.1.7(2) on price determination, with Article 7.4.13(2) on agreed payment for non-performance and Article 10.3(2) on limitation periods. Exceptionally, the mandatory character of a provision is only implicit and follows from the content and purpose of the provision itself (see, e.g., Articles 1.8 and 7.1.6).

**ARTICLE 1.6**

*(Interpretation and supplementation of the Principles)*

**(1) In the interpretation of these Principles, regard is to be had to their international character and to their purposes including the need to promote uniformity in their application.**

**(2) Issues within the scope of these Principles but not expressly settled by them are as far as possible to be settled in accordance with their underlying general principles.**

**COMMENT****1. Interpretation of the Principles as opposed to interpretation of the contract**

The Principles, like any other legal text, be it of a legislative or of a contractual nature, may give rise to doubts as to the precise meaning of their content. The interpretation of the Principles is however different from that of the individual contracts to which they apply. Even if the Principles are considered to bind the parties only at contractual level, i.e. their application is made dependent on their incorporation in individual contracts, they remain an autonomous set of rules worked out with a view to their application in a uniform manner to an indefinite number of contracts of different type entered into in various parts of the world. As a consequence they must be interpreted in a different manner from the terms of each individual contract. The rules for the interpretation of contracts (as well as of statements by or other conduct of the parties) are laid down in Chapter 4. This Article deals with the manner in which the Principles as such are to be interpreted.

**2. Regard to the international character of the Principles**

The first criterion laid down by this Article for the interpretation of the Principles is that regard is to be had to their “international character”. This means that their terms and concepts are to be interpreted autonomously, i.e. in the context of the Principles themselves and not by reference to the meaning which might traditionally be attached to them by a particular domestic law.

Such an approach becomes necessary if it is recalled that the Principles are the result of thorough comparative studies carried out by lawyers coming from totally different cultural and legal backgrounds. When drafting the individual provisions, these experts had to find sufficiently neutral legal language on which they could reach a common understanding. Even in the exceptional cases where terms or concepts peculiar to one or more national laws are employed, the intention was never to use them in their traditional meaning.

### **3. Purposes of the Principles**

By stating that in the interpretation of the Principles regard is to be had to their purposes, this Article makes it clear that they are not to be construed in a strict and literal sense but in the light of the purposes and the rationale underlying the individual provisions as well as the Principles as a whole. The purpose of the individual provisions can be ascertained both from the text itself and from the comments thereon. As to the purposes of the Principles as a whole, this Article, in view of the fact that the Principles' main objective is to provide a uniform framework for international commercial contracts, expressly refers to the need to promote uniformity in their application, i.e. to ensure that in practice they are to the greatest possible extent interpreted and applied in the same way in different countries. As to other purposes, see the remarks contained in the Introduction. See further Article 1.7 which, although addressed to the parties, may also be seen as an expression of the underlying purpose of the Principles as such to promote the observance of good faith and fair dealing in contractual relations.

### **4. Supplementation of the Principles**

A number of issues which would fall within the scope of the Principles are not settled expressly by them. In order to determine whether an issue is one that falls within the scope of the Principles even though it is not expressly settled by them, or whether it actually falls outside their scope, regard is to be had first to what is expressly stated either in the text or in the Comments (see, e.g., Comment 3 on Article 1.3; Comment 5 on Article 1.4; Article 2.2.1(2) and (3) and Comment 5 on Article 2.2.1; Comment 5 on Article 2.2.7; Comment 5 on Article 2.2.9; Comment 1 on Article 2.2.10; Article 3.1.1; Comment 1 on Article 6.1.14; Article 9.1.2; Article 9.2.2; Article 9.3.2). A useful additional guide in this respect is the subject-matter index of the Principles.

The need to promote uniformity in the application of the Principles implies that when such gaps arise a solution should be found, whenever possible, within the system of the Principles itself before resorting to domestic laws.

The first step is to attempt to settle the unsolved question through an application by analogy of specific provisions. Thus, Article 6.1.6 on place of performance should also govern restitution. Similarly, the rules laid down in Article 6.1.9 with respect to the case where a monetary obligation is expressed in a currency other than that of the place for payment may also be applied when the monetary obligation is expressed by reference to units of account such as the Special Drawing Right (SDR). If the issue cannot be solved by a mere extension of specific provisions dealing with analogous cases, recourse must be made to their underlying general principles, i.e. to the principles and rules which may be applied on a much wider scale because of their general character. Some of these fundamental principles are expressly stated in the Principles (see, e.g., Articles 1.1, 1.3, 1.5, 1.7 and 1.8). Others have to be extracted from specific provisions, i.e. the particular rules contained therein must be analysed in order to see whether they can be considered an expression of a more general principle, and as such capable of being applied also to cases different from those specifically regulated.

Parties are of course always free to agree on a particular national law to which reference should be made for the supplementing of the Principles. A provision of this kind could read “This contract is governed by the UNIDROIT Principles supplemented by the law of Country X”, or “This contract shall be interpreted and executed in accordance with the UNIDROIT Principles. Questions not expressly settled therein shall be settled in accordance with the law of Country X” (see the Model Clause in the footnote to the second paragraph of the Preamble).

#### **ARTICLE 1.7**

*(Good faith and fair dealing)*

- (1) Each party must act in accordance with good faith and fair dealing in international trade.**
- (2) The parties may not exclude or limit this duty.**

## COMMENT

**1. “Good faith and fair dealing” as a fundamental idea underlying the Principles**

There are a number of provisions throughout the different Chapters of the Principles which constitute a direct or indirect application of the principle of good faith and fair dealing. See above all Article 1.8, but see also for instance, Articles 1.9(2); 2.1.4(2)(b), 2.1.15, 2.1.16, 2.1.18 and 2.1.20; 2.2.4(2), 2.2.5(2), 2.2.7 and 2.2.10; 3.2.2, 3.2.5 and 3.2.7; 4.1(2), 4.2(2), 4.6 and 4.8; 5.1.2 and 5.1.3; 5.2.5; 5.3.3 and 5.3.4; 6.1.3, 6.1.5, 6.1.16(2) and 6.1.17(1); 6.2.3(3)(4); 7.1.2, 7.1.6 and 7.1.7; 7.2.2(b)(c); 7.4.8 and 7.4.13; 9.1.3, 9.1.4 and 9.1.10(1). This means that good faith and fair dealing may be considered to be one of the fundamental ideas underlying the Principles. By stating in general terms that each party must act in accordance with good faith and fair dealing, paragraph (1) of this Article makes it clear that even in the absence of special provisions in the Principles the parties' behaviour throughout the life of the contract, including the negotiation process, must conform to good faith and fair dealing.

**Illustrations**

1. A grants B forty-eight hours as the time within which B may accept its offer. When B, shortly before the expiry of the deadline, decides to accept, it is unable to do so: it is the weekend, the fax at A's office is disconnected and there is no telephone answering machine which can take the message. When on the following Monday A refuses B's acceptance A acts contrary to good faith since when it fixed the time-limit for acceptance it was for A to ensure that messages could be received at its office throughout the forty-eight hour period.
2. A contract for the supply and installation of a special production line contains a provision according to which A, the seller, is obliged to communicate to B, the purchaser, any improvements made by A to the technology of that line. After a year B learns of an important improvement of which it had not been informed. A is not excused by the fact that the production of that particular type of production line is no longer its responsibility but that of C, a wholly-owned affiliated company of A. It would be against good faith for A to invoke the separate entity of C, which was specifically set up to take over this production in order to avoid A's contractual obligations vis-à-vis B.
3. A, an agent, undertakes on behalf of B, the principal, to promote the sale of B's goods in a given area. Under the contract A's right to compensation arises only after B's approval of the contracts procured

by A. While B is free to decide whether or not to approve the contracts procured by A, a systematic and unjustified refusal to approve any contract procured by A would be against good faith.

4. Under a line of credit agreement between A, a bank, and B, a customer, A suddenly and inexplicably refuses to make further advances to B whose business suffers heavy losses as a consequence. Notwithstanding the fact that the agreement contains a term permitting A to accelerate payment “at will”, A’s demand for payment in full without prior warning and with no justification would be against good faith.

## **2. Abuse of rights**

A typical example of behaviour contrary to the principle of good faith and fair dealing is what in some legal systems is known as “abuse of rights”. It is characterised by a party’s malicious behaviour which occurs for instance when a party exercises a right merely to damage the other party or for a purpose other than the one for which it had been granted, or when the exercise of a right is disproportionate to the originally intended result.

### **Illustrations**

5. A rents premises from B for the purpose of setting up a retail business. The rental contract is for five years, but when three years later A realises that business in the area is very poor, it decides to close the business and informs B that it is no longer interested in renting the premises. A’s breach of contract would normally lead to B’s having the choice of either terminating the contract and claiming damages or requesting specific performance. However, under the circumstances B would be abusing its rights if it required A to pay the rent for the remaining two years of the contract instead of terminating the contract and claiming damages from A for the rent it has lost for the length of time necessary to find a new tenant.

6. A rents premises from B for the purpose of opening a restaurant. During the summer months A sets up a few tables out of doors, but still on the owner’s property. On account of the noise caused by the restaurant’s customers late at night, B has increasing difficulties finding tenants for apartments in the same building. B would be abusing its rights if, instead of requesting A to desist from serving out of doors late at night, it required A not to serve out of doors at all.

## **3. “Good faith and fair dealing in international trade”**

The reference to “good faith and fair dealing in international trade” first makes it clear that in the context of the Principles the two concepts



are not to be applied according to the standards ordinarily adopted within the different national legal systems. In other words, such domestic standards may be taken into account only to the extent that they are shown to be generally accepted among the various legal systems. A further implication of the formula used is that good faith and fair dealing must be construed in the light of the special conditions of international trade. Standards of business practice may indeed vary considerably from one trade sector to another, and even within a given trade sector they may be more or less stringent depending on the socio-economic environment in which the enterprises operate, their size and technical skill, etc.

It should be noted that whenever the provisions of the Principles and/or the comments thereto refer only to “good faith and fair dealing”, such references should always be understood as a reference to “good faith and fair dealing in international trade” as specified in this Article.

### Illustrations

7. Under a contract for the sale of high-technology equipment the purchaser loses the right to rely on any defect in the goods if it does not give notice to the seller specifying the nature of the defect without undue delay after it has discovered or ought to have discovered the defect. A, a buyer operating in a country where such equipment is commonly used, discovers a defect in the equipment after having put it into operation, but in its notice to B, the seller of the equipment, A gives misleading indications as to the nature of the defect. A loses its right to rely on the defect since a more careful examination of the defect would have permitted it to give B the necessary specifications.

8. The facts are the same as in Illustration 7, except that A operates in a country where this type of equipment is so far almost unknown. A does not lose its right to rely on the defect because B, being aware of A's lack of technical knowledge, could not reasonably have expected A properly to identify the nature of the defect.

#### **4. The mandatory nature of the principle of good faith and fair dealing**

The parties' duty to act in accordance with good faith and fair dealing is of such a fundamental nature that the parties may not contractually exclude or limit it (paragraph (2)). As to specific applications of the general prohibition to exclude or limit the principle of good faith and fair dealing between the parties, see Articles 3.1.4, 7.1.6 and 7.4.13.

On the other hand, nothing prevents parties from providing in their contract for a duty to observe more stringent standards of behaviour (see, e.g., Article 5.3.3).

### **ARTICLE 1.8**

*(Inconsistent behaviour)*

**A party cannot act inconsistently with an understanding it has caused the other party to have and upon which that other party reasonably has acted in reliance to its detriment.**

#### **COMMENT**

##### **1. Inconsistent behaviour and “good faith and fair dealing”**

This provision is a general application of the principle of good faith and fair dealing (Article 1.7). It is reflected in other more specific provisions of the Principles (see, for example, Articles 2.1.4(2)(b), 2.1.18, 2.1.20, 2.2.5(2) and Comment 3 on Article 10.4). It imposes a responsibility on a party not to occasion detriment to another party by acting inconsistently with an understanding concerning their contractual relationship which it has caused that other party to have and upon which that other party has reasonably acted in reliance.

The prohibition contained in this Article can result in the creation of rights and in the loss, suspension or modification of rights otherwise than by agreement of the parties. This is because the understanding relied upon may itself be inconsistent with the agreed or actual rights of the parties. The Article does not provide the only means by which a right might be lost or suspended because of one party's conduct (see, for example, Articles 3.2.9 and 7.1.4(3)).

## 2. An understanding reasonably relied upon

There is a variety of ways in which one party may cause the other party to have an understanding concerning their contract, its performance, or enforcement. The understanding may result, for example, from a representation made, from conduct, or from silence when a party would reasonably expect the other to speak to correct a known error or misunderstanding that was being relied upon.

So long as it relates in some way to the contractual relationship of the parties, the understanding for the purposes of this Article is not limited to any particular subject-matter. It may relate to a matter of fact or of law, to a matter of intention, or to how one or other of the parties can or must act.

The important limitation is that the understanding must be one on which, in the circumstances, the other party can and does reasonably rely. Whether the reliance is reasonable is a matter of fact in the circumstances having regard, in particular, to the communications and conduct of the parties, to the nature and setting of the parties' dealings and to the expectations they could reasonably entertain of each other.

### Illustrations

1. A has negotiated with B over a lengthy period for a contract of lease of B's land under which B is to demolish a building and construct a new one to A's specification. A communicates with B in terms that induce B reasonably to understand that their contract negotiations have been completed, and that B can begin performance. B then demolishes the building and engages contractors to build the new building. A is aware of this and does nothing to stop it. A later indicates to B that there are additional terms still to be negotiated. A will be precluded from departing from B's understanding.
2. B mistakenly understands that its contract with A can be performed in a particular way. A is aware of this and stands by while B's performance proceeds. B and A meet regularly. B's performance is discussed but no reference is made by A to B's mistake. A will be precluded from insisting that the performance was not that which was required under the contract.
3. A regularly uses B to do sub-contract work on building sites. That part of A's business and the employees involved in it are taken over by A1, a related business. There is no change in the general course of business by which B obtains its instruction to do work. B continues to provide sub-contract services and continues to bill A for work done believing the work is being done for A. A does not inform B of its mistake. A is precluded from denying that B's contract for work done is with it and must pay for the work done.

4. Because of difficulties it is experiencing with its own suppliers, A is unable to make deliveries on time to B under their contract. The contract imposes penalties for late delivery. After being made aware of A's difficulties, B indicates it will not insist on strict compliance with the delivery schedule. A year later B's business begins to suffer from A's late deliveries. B seeks to recover penalties for the late deliveries to date and to require compliance with the delivery schedule for the future. It will be precluded from recovering the penalties but will be able to insist on compliance with the schedule if reasonable notice is given that compliance is required for the future.

5. B is indebted to A in the sum of AUD 10,000. Though the debt is due A takes no steps to enforce it. B assumes in consequence that A has pardoned the debt. A has done nothing to indicate that such actually is the case. It later demands payment. B cannot rely on A's inaction to resist that demand.

### **3. Detriment and preclusion**

The responsibility imposed by the Article is to avoid detriment being occasioned in consequence of reasonable reliance. This does not necessarily require that the party seeking to act inconsistently must be precluded from so doing. Preclusion is only one way of avoiding detriment. There may, in the circumstances, be other reasonable means available that can avert the detriment the relying party would otherwise experience if the inconsistent action were allowed as, for example, by giving reasonable notice before acting inconsistently (see Illustration 4), or by paying for costs or losses incurred by reason of reliance.

#### **Illustrations**

6. A and B are parties to a construction contract which requires that additional works be documented in writing and be certified by the site architect. A's contract manager orally requests B to do specified additional work on a time and materials basis and assures B it will be documented appropriately in due course. B commissions design works for the additional work at which stage A indicates that the work is not required. The cost incurred in commissioning the design work is far less than the cost that would be incurred if the additional work were to be done. If A pays B the costs incurred by B for the design work, B cannot then complain of A's inconsistent behaviour.

7. A fails to meet on time a prescribed milestone in a software development contract with B. B is entitled under the contract to terminate the contract because of that failure. B continues to require and pay for changes to the software and acts co-operatively with A in continuing the software development program. A's continued performance is based on B's conduct subsequent to the breach. B will in such circumstances be precluded from exercising its right to terminate for the failure to meet the milestone. However, under the Principles B will be able to allow A an additional period of time for performance (see Article 7.1.5) and to exercise its right to terminate if the milestone is not met in that period.

## ARTICLE 1.9

*(Usages and practices)*

**(1) The parties are bound by any usage to which they have agreed and by any practices which they have established between themselves.**

**(2) The parties are bound by a usage that is widely known to and regularly observed in international trade by parties in the particular trade concerned except where the application of such a usage would be unreasonable.**

### COMMENT

#### **1. Practices and usages in the context of the Principles**

This Article lays down the principle according to which the parties are in general bound by practices and usages which meet the requirements set forth in the Article. Furthermore, these same requirements must be met by practices and usages for them to be applicable in the cases and for the purposes expressly indicated in the Principles (see, for instance, Articles 2.1.6(3), 4.3, and 5.1.2).

#### **2. Practices established between the parties**

A practice established between the parties to a particular contract is automatically binding, except where the parties have expressly excluded its application. Whether a particular practice can be deemed to be “established” between the parties will naturally depend on the

circumstances of the case, but behaviour on the occasion of only one previous transaction between the parties will not normally suffice.

#### **Illustration**

1. A, a supplier, has repeatedly accepted claims from B, a customer, for quantitative or qualitative defects in the goods as much as two weeks after their delivery. When B gives another notice of defects after a fortnight, A cannot object that it is too late since the two-weeks' notice amounts to a practice established between A and B which will as such be binding on A.

### **3. Agreed usages**

By stating that the parties are bound by usages to which they have agreed, paragraph (1) of this Article merely applies the general principle of freedom of contract laid down in Article 1.1. Indeed, the parties may either negotiate all the terms of their contract, or for certain questions simply refer to other sources including usages. The parties may stipulate the application of any usage, including a usage developed within a trade sector to which neither party belongs, or a usage relating to a different type of contract. It is even conceivable that the parties will agree on the application of what sometimes misleadingly are called usages, i.e. a set of rules issued by a particular trade association under the title of "Usages", but which only in part reflects established general lines of conduct.

### **4. Other applicable usages**

Paragraph (2) lays down the criteria for the identification of usages applicable in the absence of a specific agreement by the parties. The fact that the usage must be "widely known to and regularly observed [...] by parties in the particular trade concerned" is a condition for the application of any usage, be it at international or merely at national or local level. The additional qualification "in international trade" is intended to avoid usages developed for, and confined to, domestic transactions also being invoked in transactions with foreigners.

#### **Illustration**

2. A, a real estate agent, invokes a particular usage of the profession in its country vis-à-vis B, a foreign customer. B is not bound by such a usage if that usage is of a local nature and relates to a trade which is predominantly domestic in character.

Only exceptionally may usages of a purely local or national origin be applied without any reference thereto by the parties. Thus, usages existing on certain commodity exchanges or at trade exhibitions or ports should be applicable provided that they are regularly followed with respect to foreigners as well. Another exception concerns the case of a businessperson who has already entered into a number of similar contracts in a foreign country and who should therefore be bound by the usages established within that country for such contracts.

### Illustrations

3. A, a terminal operator, invokes a particular usage of the port where it is located vis-à-vis B, a foreign carrier. B is bound by this local usage if the port is normally used by foreigners and the usage in question has been regularly observed with respect to all customers, irrespective of their place of business and of their nationality.
4. A, a sales agent from Country X, receives a request from B, one of its customers in Country Y, for the customary 10% discount upon payment of the price in cash. A may not object to the application of such a usage on account of its being restricted to Country Y if A has been doing business in that country for a certain period of time.

## 5. Application of usage unreasonable

A usage may be regularly observed by the generality of business people in a particular trade sector but its application in a given case may nevertheless be unreasonable. Reasons for this may be found in the particular conditions in which one or both parties operate and/or the atypical nature of the transaction. In such cases the usage will not be applied.

### Illustration

5. A usage exists in a commodity trade sector according to which the purchaser may not rely on defects in the goods if they are not duly certified by an internationally recognised inspection agency. When A, a buyer, takes over the goods at the port of destination, the only internationally recognised inspection agency operating in that port is on strike and to call another from the nearest port would be excessively costly. The application of the usage in this case would be unreasonable and A may rely on the defects it has discovered even though they have not been certified by an internationally recognised inspection agency.

**6. Usages prevail over the Principles**

Both courses of dealing and usages, once they are applicable in a given case, prevail over conflicting provisions contained in the Principles. The reason for this is that they bind the parties as implied terms of the contract as a whole or of single statements or other conduct on the part of one of the parties. As such, they are superseded by any express term stipulated by the parties but, in the same way as the latter, they prevail over the Principles, the only exception being those provisions which are specifically declared to be of a mandatory character (see Comment 3 on Article 1.5).

**ARTICLE 1.10**

*(Notice)*

**(1) Where notice is required it may be given by any means appropriate to the circumstances.**

**(2) A notice is effective when it reaches the person to whom it is given.**

**(3) For the purpose of paragraph (2) a notice “reaches” a person when given to that person orally or delivered at that person’s place of business or mailing address.**

**(4) For the purpose of this Article “notice” includes a declaration, demand, request or any other communication of intention.**

**COMMENT****1. Form of notice**

This Article first lays down the principle that notice or any other kind of communication of intention (declarations, demands, requests, etc.) required by individual provisions of the Principles are not subject to any particular requirement as to form, but may be given by any means appropriate in the circumstances. Which means are appropriate will depend on the actual circumstances of the case, in particular on the availability and the reliability of the various modes of communication, and the importance and/or urgency of the message to be delivered. For an electronic notice to be “appropriate to the circumstances”



the addressee must expressly or impliedly have consented to receive electronic communications in the way in which the notice was sent by the sender, i.e. of that type, in that format and to that address. The addressee's consent may be inferred from the addressee's statements or conduct, from practices established between the parties, or from applicable usages.

### Illustrations

1. Seller A and buyer B have a longstanding business relationship in the course of which they have always negotiated and concluded their contracts by telephone. On discovering a defect in the goods supplied on one occasion, B immediately sends A notice thereof by e-mail. A, who does not regularly read its e-mail and had no reason to expect an e-mail from B, on discovering B's notice three weeks after it had been sent rejects it as being too late. B may not object that it had given prompt notice of the defects since the notice was not given by a means appropriate to the circumstances.
2. Seller A and buyer B have a longstanding business relationship in the course of which they have regularly communicated by electronic means. On discovering a defect in the goods supplied on one occasion, B immediately sends A notice thereof by e-mail to an e-mail address different from the one normally used. A, who had no reason to expect an e-mail from B at that address, on discovering B's notice three weeks after it had been sent rejects it as being too late. B may not object that it had given prompt notice of the defects since the notice was not given by a means appropriate to the circumstances.

## 2. Receipt principle

With respect to all kinds of notices the Principles adopt the so-called "receipt" principle, i.e. they are not effective unless and until they reach the person to whom they are given. For some communications this is expressly stated in the provisions dealing with them: see Articles 2.1.3(1), 2.1.3(2), 2.1.5, 2.1.6(2), 2.1.8(1) and 2.1.10; 9.1.10 and 9.1.11. The purpose of paragraph (2) of this Article is to indicate that the same will also be true in the absence of an express statement to this effect: see Articles 2.1.9, 2.1.11; 2.2.9; 3.2.10, 3.2.11; 6.1.16, 6.2.3; 7.1.5, 7.1.7; 7.2.1, 7.2.2; 7.3.2, 7.3.4; and 8.3.

## 3. Dispatch principle to be expressly stipulated

The parties are of course always free expressly to stipulate the application of the dispatch principle. This may be appropriate in

particular with respect to the notice a party has to give in order to preserve its rights in cases of the other party's actual or anticipated non-performance when it would not be fair to place the risk of loss, mistake or delay in the transmission of the message on the former. This is all the more true if the difficulties which may arise at international level in proving effective receipt of a notice are borne in mind.

#### **4. “Reaches”**

It is important in relation to the receipt principle to determine precisely when the communications in question “reach” the addressee. In an attempt to define the concept, paragraph (3) of this Article draws a distinction between oral and other communications. The former “reach” the addressee if they are made personally to it or to another person authorised by it to receive them. The latter “reach” the addressee as soon as they are delivered either to the addressee personally or to its place of business or (electronic) mailing address. The particular communication in question need not come into the hands of the addressee or actually be read by the addressee. It is sufficient that it be handed over to an employee of the addressee authorised to accept it, or that it be placed in the addressee's mailbox, or received by the addressee's fax or telex machine, or, in the case of electronic communications when it becomes capable of being retrieved by the addressee at an electronic address designated by the addressee (see Article 10(2) of the 2005 United Nations Convention on the Use of Electronic Communications in International Contracts).

### **ARTICLE 1.11**

#### *(Definitions)*

##### **In these Principles**

- “court” includes an arbitral tribunal;
- where a party has more than one place of business the relevant “place of business” is that which has the closest relationship to the contract and its performance, having regard to the circumstances known to or contemplated by the parties at any time before or at the conclusion of the contract;

- “obligor” refers to the party who is to perform an obligation and “obligee” refers to the party who is entitled to performance of that obligation;
- “writing” means any mode of communication that preserves a record of the information contained therein and is capable of being reproduced in tangible form.

## COMMENT

### 1. Courts and arbitral tribunals

The importance of the Principles for the purpose of the settlement of disputes by means of arbitration has already been stressed (see above the Comments on the Preamble). In order however to avoid undue heaviness of language, only the term “court” is used in the text of the Principles, on the understanding that it covers arbitral tribunals as well as courts.

### 2. Party with more than one place of business

For the purpose of the application of the Principles a party’s place of business is of relevance in a number of contexts such as the place for the delivery of notices (see Article 1.10(3)); a possible extension of the time of acceptance because of a holiday falling on the last day (see Article 1.12); the place of performance (Article 6.1.6) and the determination of the party who should apply for a public permission (Article 6.1.14(a)).

With reference to a party with multiple places of business (normally a central office and various branch offices) this Article lays down the rule that the relevant place of business should be considered to be that which has the closest relationship to the contract and to its performance. Nothing is said with respect to the case where the place of the conclusion of the contract and that of performance differ, but in such a case the latter would seem to be the more relevant one. In the determination of the place of business which has the closest relationship to a given contract and to its performance, regard is to be had to the circumstances known to or contemplated by both parties at any time before or at the conclusion of the contract. Facts known only to one of the parties or of which the parties became aware only after the conclusion of the contract cannot be taken into consideration.

### 3. “Obligor” – “obligee”

Where necessary, to better identify the party performing and the party receiving performance of obligations the terms “obligor” and “obligee” are used, irrespective of whether the obligation is non-monetary or monetary.

### 4. “Writing”

In some cases the Principles refer to a “writing” or a “contract in writing” (see Articles 2.1.12, 2.1.17 and 2.1.18). The Principles define this formal requirement in functional terms. Thus, a writing includes not only a telegram and a telex, but also any other mode of communication, including electronic communications, that preserves a record and can be reproduced in tangible form. This formal requirement should be compared with the more flexible form of a “notice” (see Article 1.10(1)).

## ARTICLE 1.12

*(Computation of time set by parties)*

**(1) Official holidays or non-business days occurring during a period set by parties for an act to be performed are included in calculating the period.**

**(2) However, if the last day of the period is an official holiday or a non-business day at the place of business of the party to perform the act, the period is extended until the first business day which follows, unless the circumstances indicate otherwise.**

**(3) The relevant time zone is that of the place of business of the party setting the time, unless the circumstances indicate otherwise.**

## COMMENT

The parties may, either unilaterally or by agreement, fix a period of time within which certain acts must be done (see, e.g., Articles 2.1.7, 2.2.9(2) and 10.3).

In fixing the time limit the parties may either indicate merely a period of time (e.g. “Notice of defects in the goods must be given within ten days after delivery”) or a precise date (e.g. “Offer firm until 1 March”).

In the first case the question arises of whether or not holidays or non-business days occurring during the period of time are included in calculating the period of time, and according to paragraph (1) of this Article the answer is in the affirmative.

In both of the above-mentioned cases, the question may arise of what the effect would be of a holiday or non-business day falling at the expiry of the fixed period of time at the place of business of the party to perform the act. Paragraph (2) provides that in such an eventuality the period is extended until the first business day that follows, unless the circumstances indicate otherwise.

Finally, whenever the parties are situated in different time zones, the question arises as to what time zone is relevant, and according to paragraph (3) it is the time zone of the place of business of the party setting the time limit, unless the circumstances indicate otherwise.

### Illustrations

1. A sales contract provides that buyer A must give notice of defects of the goods within 10 days after delivery. The goods are delivered on Friday 16 December. A gives notice of defects on Monday 2 January and seller B rejects it as being untimely. A may not object that the holidays and non-business days which occurred between 16 December and 2 January should not be counted when calculating the ten days of the time limit.
2. Offeror A indicates that its offer is firm until 1 March. Offeree B accepts the offer on 2 March because 1 March was a holiday at its place of business. A may not object that the fixed time limit for acceptance had expired on 1 March.
3. Offeror A sends an offer to offeree B by e-mail on a Saturday indicating that the offer is firm for 24 hours. If B intends to accept, it must do so within 24 hours, even though the time limit elapses on a Sunday, since under the circumstances the time limit fixed by A was to be understood as absolute.
4. The facts are the same as in Illustration 2, except that A is situated in Frankfurt and B in New York, and the time limit fixed for acceptance is “by 5 p.m. tomorrow at the latest”. B must accept by 5 p.m. Frankfurt time.

5. A charterparty concluded between owner A, situated in Tokyo, and charterer B, situated in Kuwait City, provides for payment of the freight by B at A's bank in Zurich, Switzerland, on a specific date by 5 p.m. at latest. The relevant time zone is neither that of A nor that of B, but that of Zurich where payment is due.

## CHAPTER 2

# FORMATION AND AUTHORITY OF AGENTS

## SECTION 1: FORMATION

### ARTICLE 2.1.1

*(Manner of formation)*

**A contract may be concluded either by the acceptance of an offer or by conduct of the parties that is sufficient to show agreement.**

#### COMMENT

#### 1. Offer and acceptance

Basic to the Principles is the idea that the agreement of the parties is, in itself, sufficient to conclude a contract (see Article 3.1.2). The concepts of offer and acceptance have traditionally been used to determine whether, and if so when, the parties have reached agreement. As this Article and this Chapter make clear, the Principles retain these concepts as essential tools of analysis.

#### 2. Conduct sufficient to show agreement

In commercial practice contracts, particularly when related to complex transactions, are often concluded after prolonged negotiations without an identifiable sequence of offer and acceptance. In such cases it may be difficult to determine if and when a contractual agreement has been reached. According to this Article a contract may be held to be concluded even though the moment of its formation cannot be determined, provided that the conduct of the parties is sufficient to show agreement. In order to determine whether there is sufficient evidence of the parties' intention to be bound by a contract, their conduct has to be interpreted in accordance with the criteria set forth in Article 4.1 *et seq.*

**Illustration**

1. A and B enter into negotiations with a view to setting up a joint venture for the development of a new product. After prolonged negotiations without any formal offer or acceptance and with some minor points still to be settled, both parties begin to perform. When subsequently the parties fail to reach an agreement on these minor points, a court or arbitral tribunal may decide that a contract was nevertheless concluded since the parties had begun to perform, thereby showing their intention to be bound by a contract.

**3. Automated contracting**

The language of this Article is sufficiently broad to cover also cases of so-called automated contracting, i.e. where the parties agree to use a system capable of setting in motion self-executing electronic actions leading to the conclusion of a contract without the intervention of a natural person.

**Illustration**

2. Automobile manufacturer A and components supplier B set up an electronic data interchange system which, as soon as A's stocks of components fall below a certain level, automatically generates orders for the components and executes such orders. The fact that A and B have agreed on the operation of such a system makes the orders and performances binding on A and B, even though they have been generated without the personal intervention of A and B.

**ARTICLE 2.1.2***(Definition of offer)*

**A proposal for concluding a contract constitutes an offer if it is sufficiently definite and indicates the intention of the offeror to be bound in case of acceptance.**

**COMMENT**

In defining an offer as distinguished from other communications which a party may make in the course of negotiations initiated with a view to concluding a contract, this Article lays down two requirements: the proposal must (i) be sufficiently definite to permit the conclusion of the contract by mere acceptance and (ii) indicate the intention of the offeror to be bound in case of acceptance.



## 1. Definiteness of an offer

Since a contract is concluded by the mere acceptance of an offer, the terms of the future agreement must already be indicated with sufficient definiteness in the offer itself. Whether a given offer meets this requirement cannot be established in general terms. Even essential terms, such as the precise description of the goods or the services to be delivered or rendered, the price to be paid for them, the time or place of performance, etc., may be left undetermined in the offer without necessarily rendering it insufficiently definite: all depends on whether or not the offeror by making the offer, and the offeree by accepting it, intend to enter into a binding agreement, and whether or not the missing terms can be determined by interpreting the language of the agreement in accordance with Articles 4.1 *et seq.*, or supplied in accordance with Articles 4.8 or 5.1.2. Indefiniteness may moreover be overcome by reference to practices established between the parties or to usages (see Article 1.9), as well as by reference to specific provisions to be found elsewhere in the Principles (e.g. Articles 5.1.6 (*Determination of quality of performance*), 5.1.7 (*Price determination*), 6.1.1 (*Time of performance*), 6.1.6 (*Place of performance*) and 6.1.10 (*Currency not expressed*)).

### Illustration

1. A has for a number of years annually renewed a contract with B for technical assistance for A's computers. A opens a second office with the same type of computers and asks B to provide assistance also for the new computers. B accepts and, despite the fact that A's offer does not specify all the terms of the agreement, a contract has been concluded since the missing terms can be taken from the previous contracts as constituting a practice established between the parties.

## 2. Intention to be bound

The second criterion for determining whether a party makes an offer for the conclusion of a contract, or merely opens negotiations, is that party's intention to be bound in the event of acceptance. Since such an intention will rarely be declared expressly, it often has to be inferred from the circumstances of each individual case. The way in which the proponent presents the proposal (e.g. by expressly defining it as

an “offer” or as a mere “declaration of intent”) provides a first, although not a decisive, indication of possible intention. Of even greater importance are the content and the addressees of the proposal. Generally speaking, the more detailed and definite the proposal, the more likely it is to be construed as an offer. A proposal addressed to one or more specific persons is more likely to be intended as an offer than is one made to the public at large.

### **Illustrations**

2. After lengthy negotiations the Executive Directors of two companies, A and B, lay down the conditions on which B will acquire 51% of the shares in company C which is totally owned by A. The “Memorandum of Agreement” signed by the negotiators contains a final clause stating that the agreement is not binding until approved by A’s Board of Directors. There is no contract before such approval is given by them.

3. A, a Government agency, advertises for bids for the setting up of a new telephone network. Such an advertisement is merely an invitation to submit offers, which may or may not be accepted by A. If, however, the advertisement indicates in detail the technical specifications of the project and states that the contract will be awarded to the lowest bid conforming to the specifications, it may amount to an offer with the consequence that the contract will be concluded once the lowest bid has been identified.

A proposal may contain all the essential terms of the contract but nevertheless not bind the proponent in case of acceptance if it makes the conclusion of the contract dependent on the reaching of agreement on some minor points left open in the proposal (see Article 2.1.13).

### **ARTICLE 2.1.3**

#### *(Withdrawal of offer)*

**(1) An offer becomes effective when it reaches the offeree.**

**(2) An offer, even if it is irrevocable, may be withdrawn if the withdrawal reaches the offeree before or at the same time as the offer.**

**COMMENT****1. When an offer becomes effective**

Paragraph (1) of this Article, which is taken literally from Article 15 CISG, provides that an offer becomes effective when it reaches the offeree (see Article 1.10(2)). For the definition of “reaches” see Article 1.10(3). The time at which the offer becomes effective is of importance as it indicates the precise moment as from which the offeree can accept it, thus definitely binding the offeror to the proposed contract.

**2. Withdrawal of an offer**

There is, however, a further reason why it may in practice be important to determine the moment at which the offer becomes effective. Indeed, up to that time the offeror is free to change its mind and to decide not to enter into the agreement at all, or to replace the original offer by a new one, irrespective of whether or not the original offer was intended to be irrevocable. The only condition is that the offeree is informed of the offeror’s altered intentions before or at the same time as the offeree is informed of the original offer. By expressly stating this, paragraph (2) of this Article makes it clear that a distinction is to be drawn between “withdrawal” and “revocation” of an offer: before an offer becomes effective it can always be withdrawn whereas the question of whether or not it may be revoked (see Article 2.1.4) arises only after that moment.

**ARTICLE 2.1.4***(Revocation of offer)*

**(1) Until a contract is concluded an offer may be revoked if the revocation reaches the offeree before it has dispatched an acceptance.**

**(2) However, an offer cannot be revoked**

**(a) if it indicates, whether by stating a fixed time for acceptance or otherwise, that it is irrevocable; or**

**(b) if it was reasonable for the offeree to rely on the offer as being irrevocable and the offeree has acted in reliance on the offer.**

**COMMENT**

The problem of whether an offer is or is not revocable is traditionally one of the most controversial issues in the context of the formation of contracts. Since there is no prospect of reconciling the two basic approaches followed in this respect by the different legal systems, i.e. the common law approach according to which an offer is as a rule revocable, and the opposite approach followed by the majority of civil law systems, the only remaining possibility is that of selecting one approach as the main rule, and the other as the exception.

**1. Offers as a rule revocable**

Paragraph (1) of this Article, which is taken literally from Article 16 CISG, states that until the contract is concluded offers are as a rule revocable. The same paragraph, however, subjects the revocation of an offer to the condition that it reach the offeree before the offeree has dispatched an acceptance. It is thus only when the offeree orally accepts the offer, or when the offeree may indicate assent by performing an act without giving notice to the offeror (see Article 2.1.6(3)), that the offeror's right to revoke the offer continues to exist until such time as the contract is concluded. Where, however, the offer is accepted by a written indication of assent, so that the contract is concluded when the acceptance reaches the offeror (see Article 2.1.6(2)), the offeror's right to revoke the offer terminates earlier, i.e. when the offeree dispatches the acceptance. Such a solution may cause some inconvenience to the offeror who will not always know whether or not it is still possible to revoke the offer. It is, however, justified in view of the legitimate interest of the offeree in the time available for revocation being shortened.

As to the determination of the time of dispatch, see Article 2.1.8 and the Comment thereto.

**2. Irrevocable offers**

Paragraph (2) provides for two important exceptions to the general rule as to the revocability of offers: (i) where the offer contains an indication that it is irrevocable and (ii) where the offeree, having other good reasons to treat the offer as being irrevocable, has acted in reliance on that offer.

*a. Indication of irrevocability contained in the offer*

The indication that the offer is irrevocable may be made in different ways, the most direct and clear of which is an express statement to that

effect by the offeror (e.g. “This is a firm offer”; “We shall stand by our offer until we receive your answer”). It may, however, simply be inferred from other statements by, or conduct of, the offeror. The indication of a fixed time for acceptance may, but need not necessarily, amount by itself to an implicit indication of an irrevocable offer. The answer must be found in each case through a proper interpretation of the terms of the offer in accordance with the various criteria laid down in the general rules on interpretation in Chapter 4. In general, if the offeror operates within a legal system where the fixing of a time for acceptance is considered to indicate irrevocability, it may be assumed that by specifying such a fixed time the offeror intends to make an irrevocable offer. If, on the other hand, the offeror operates in a legal system where the fixing of a time for acceptance is not sufficient to indicate irrevocability, the offeror will not normally have had such an intention.

### Illustrations

1. A, a travel agency, informs a client of a cruise in its brochure for the coming New Year holidays. It urges the client to book within the next three days, adding that after that date there will probably be no more places left. This statement by itself will not be considered to indicate that the offer is irrevocable during the first three days.
2. A invites B to submit a written offer of the terms on which B is prepared to construct a building. B presents a detailed offer containing the statement “Price and other conditions are not good after 1 September”. If A and B operate within a legal system where such a statement is considered to be an indication that the offer is irrevocable until the specified date, B can expect the offer to be understood as being irrevocable. The same may not necessarily be the case if the offeree operates in a legal system where such a statement is not considered as being sufficient to indicate that the offer is irrevocable.

#### b. *Reliance by offeree on irrevocability of offer*

The second exception to the general rule regarding the revocability of offers, i.e. where “it was reasonable for the offeree to rely on the offer as being irrevocable”, and “the offeree has acted in reliance on the offer”, is an application of the general principle prohibiting inconsistent behaviour laid down in Article 1.8. The reasonable reliance of the offeree may have been induced either by the conduct of the offeror, or by the nature of the offer itself (e.g. an offer whose acceptance

requires extensive and costly investigation on the part of the offeree or an offer made with a view to permitting the offeree in turn to make an offer to a third party). The acts which the offeree must have performed in reliance on the offer may consist in making preparations for production, buying or hiring of materials or equipment, incurring expenses etc., provided that such acts could have been regarded as normal in the trade concerned, or should otherwise have been foreseen by, or known to, the offeror.

### **Illustrations**

3. A, an antique dealer, asks B to restore ten paintings on condition that the work is completed within three months and that the price does not exceed a specific amount. B informs A that, so as to know whether or not to accept the offer, B finds it necessary to begin work on one painting and will then give a definite answer within five days. A agrees, and B, relying on A's offer, begins work immediately. A may not revoke the offer during those five days.

4. A seeks an offer from B for incorporation in a bid on a project to be assigned within a stated time. B submits an offer on which A relies when calculating the price of the bid. Before the expiry of the date, but after A has made the bid, B informs A that it is no longer willing to stand by its offer. B's offer is irrevocable until the stated date since in making its bid A relied on B's offer.

### **ARTICLE 2.1.5**

*(Rejection of offer)*

**An offer is terminated when a rejection reaches the offeror.**

### **COMMENT**

#### **1. Rejection may be express or implied**

An offer may be rejected either expressly or impliedly. A frequent case of implied rejection is a reply to an offer which purports to be an acceptance but which contains additions, limitations or other modifications (see Article 2.1.11(1)).

In the absence of an express rejection the statements by, or the conduct of, the offeree must in any event be such as to justify the belief of the offeror that the offeree has no intention of accepting the offer. A reply on the part of the offeree which merely asks whether there would be a possible alternative (e.g. “Is there any chance of the price being reduced?”, or “Could you deliver a couple of days earlier?”) would not normally be sufficient to justify such a conclusion.

It should be recalled that a rejection will bring about the termination of any offer, irrespective of whether it was revocable or irrevocable according to Article 2.1.4.

#### Illustration

A receives an offer from B stating that the offer will be firm for two weeks. A replies by return of post asking for partially different conditions which B does not accept. A may no longer accept the original offer even though there are still several days left before the expiry of the two week period since by making a counter-offer A implicitly rejected the original offer.

## 2. Rejection only one cause of termination of an offer

Rejection by the offeree is only one of the causes of termination of an offer. Other causes are dealt with in Articles 2.1.4(1) and 2.1.7.

### ARTICLE 2.1.6

*(Mode of acceptance)*

**(1) A statement made by or other conduct of the offeree indicating assent to an offer is an acceptance. Silence or inactivity does not in itself amount to acceptance.**

**(2) An acceptance of an offer becomes effective when the indication of assent reaches the offeror.**

**(3) However, if, by virtue of the offer or as a result of practices which the parties have established between themselves or of usage, the offeree may indicate assent by performing an act without notice to the offeror, the acceptance is effective when the act is performed.**

**COMMENT****1. Indication of assent to an offer**

For there to be an acceptance the offeree must in one way or another indicate “assent” to the offer. The mere acknowledgement of receipt of the offer, or an expression of interest in it, is not sufficient. Furthermore, the assent must be unconditional, i.e. it cannot be made dependent on some further step to be taken by either the offeror (e.g. “Our acceptance is subject to your final approval”) or the offeree (e.g. “We hereby accept the terms of the contract as set forth in your Memorandum and undertake to submit the contract to our Board for approval within the next two weeks”). Finally, the purported acceptance must contain no variation of the terms of the offer or at least none which materially alters them (see Article 2.1.11).

**2. Acceptance by conduct**

Provided that the offer does not impose any particular mode of acceptance, the indication of assent may either be made by an express statement or be inferred from the conduct of the offeree. Paragraph (1) of this Article does not specify the form such conduct should assume: most often it will consist in acts of performance, such as the payment of an advance on the price, the shipment of goods or the beginning of work at the site, etc.

**3. Silence or inactivity**

By stating that “[s]ilence or inactivity does not in itself amount to acceptance”, paragraph (1) makes it clear that as a rule mere silence or inactivity on the part of the offeree does not allow the inference that the offeree assents to the offer. The situation is different if the parties themselves agree that silence shall amount to acceptance, or if there exists a course of dealing or usage to that effect. In no event, however, is it sufficient for the offeror to state unilaterally in its offer that the offer will be deemed to have been accepted in the absence of any reply from the offeree. Since it is the offeror who takes the initiative by proposing the conclusion of the contract, the offeree is free not only to accept or not to accept the offer, but also simply to ignore it.

**Illustrations**

1. A requests B to set out the conditions for the renewal of a contract for the supply of wine, due to expire on 31 December. In its offer B includes a provision stating that “if we have not heard from you at the latest by the end of November, we will assume that you



have agreed to renew the contract on the conditions indicated above". A finds the proposed conditions totally unacceptable and does not even reply. The former contract expires on the fixed date without a new contract having been agreed between the parties.

2. Under a long-term agreement for the supply of wine B regularly met A's orders without expressly confirming its acceptance. On 15 November A orders a large stock for New Year. B does not reply, nor does it deliver at the requested time. B is in breach since, in accordance with the practice established between the parties, B's silence in regard to A's order amounts to an acceptance.

#### **4. When acceptance becomes effective**

According to paragraph (2), an acceptance becomes effective at the moment the indication of assent reaches the offeror (see Article 1.10(2)). For the definition of "reaches" see Article 1.10(3). The reason for the adoption of the "receipt" principle in preference to the "dispatch" principle is that the risk of transmission is better placed on the offeree than on the offeror, since it is the former who chooses the means of communication, who knows whether the chosen means of communication is subject to special risks or delay, and who is consequently best able to take measures to ensure that the acceptance reaches its destination.

As a rule, an acceptance by means of mere conduct likewise becomes effective only when notice thereof reaches the offeror. It should be noted, however, that special notice to this effect by the offeree will be necessary only in cases where the conduct will not of itself give notice of acceptance to the offeror within a reasonable period of time. In all other cases, e.g. where the conduct consists in the payment of the price, or the shipment of the goods by air or by some other rapid mode of transportation, the same effect may well be achieved simply by the bank or the carrier informing the offeror of the funds transfer or of the consignment of the goods.

An exception to the general rule of paragraph (2) is to be found in the cases envisaged in paragraph (3), i.e. where "by virtue of the offer or as a result of practices which the parties have established between themselves or of usage, the offeree may indicate assent by performing an act without notice to the offeror". In such cases the acceptance is effective at the moment the act is performed, irrespective of whether or not the offeror is promptly informed thereof.

## Illustrations

3. A asks B to write a special program for the setting up of a data bank. Without giving A notice of acceptance, B begins to write the program and, after its completion, insists on payment in accordance with the terms set out in A's offer. B is not entitled to payment since B's purported acceptance of A's offer never became effective as B never notified A of it.

4. The facts are the same as in Illustration 3, except that in the offer B is informed of A's absence for the following two weeks, and that if B intends to accept the offer B should begin writing the program immediately so as to save time. The contract is concluded once B begins to perform, even if B fails to inform A thereof either immediately or at a later stage.

This Article corresponds to paragraphs (1), (2) first part and (3) of Article 18 CISG.

**ARTICLE 2.1.7**

*(Time of acceptance)*

**An offer must be accepted within the time the offeror has fixed or, if no time is fixed, within a reasonable time having regard to the circumstances, including the rapidity of the means of communication employed by the offeror. An oral offer must be accepted immediately unless the circumstances indicate otherwise.**

**COMMENT**

With respect to the time within which an offer must be accepted, this Article, which corresponds to the second part of paragraph (2) of Article 18 CISG, distinguishes between written and oral offers.

As concerns written offers, all depends upon whether or not the offer indicated a specific time for acceptance: if it did, the offer must be accepted within that time, while in all other cases the indication of assent must reach the offeror "within a reasonable time having regard to the circumstances, including the rapidity of the means of communication employed by the offeror".

### Illustrations

1. A sends B an offer on Monday indicating that if B intends to accept, it must do so by Friday at the latest. B's acceptance reaches A on the Monday of the following week. A may reject B's acceptance as being too late.
2. A sends B an offer on Monday morning by e-mail, urging B to reply "as soon as possible". Although on previous occasions A and B had already communicated by e-mail, B accepts A's offer by letter which reaches A on Thursday. B's acceptance is too late since under the circumstances an acceptance by a letter which reaches A three days after its e-mail was not made "as soon as possible".

Oral offers must be accepted immediately unless the circumstances indicate otherwise. An offer is to be considered oral not only when made in the presence of the offeree, but whenever the offeree can respond immediately. This is the case of an offer made over the phone or communicated electronically in real time.

It is important to note that the rules laid down in this Article also apply to situations where, in accordance with Article 2.1.6(3), the offeree may indicate assent by performing an act without notice to the offeror: in these cases it is the act of performance which has to be accomplished within the respective periods of time.

For the determination of the precise starting point of the period of time fixed by the offeror, see Article 2.1.8; as to the calculation of holidays falling within that period of time, see Article 1.12; as to cases of late acceptance and of delay in transmission, see Article 2.1.9.

### ARTICLE 2.1.8

*(Acceptance within a fixed period of time)*

**A period of acceptance fixed by the offeror begins to run from the time that the offer is dispatched. A time indicated in the offer is deemed to be the time of dispatch unless the circumstances indicate otherwise.**

### COMMENT

Whenever an offeror fixes a period of time for acceptance the question arises of when the period begins to run. According to this Article it begins to run from the moment the offer is dispatched, i.e.

has left the sphere of control of the offeror. As to when this occurs there is a presumption that the time of dispatch is the time indicated in the offer. For instance, in the case of a letter, the date of despatch will be the date shown on the letter; in the case of an e-mail, it will be the time indicated as the sending time by the offeror's server; etc. However, the presumption may be rebutted if in a given case the circumstances indicate otherwise. Thus, if the date shown on a fax letter is prior to the sending date printed by the fax machine, the latter date should prevail. Likewise, if the date shown on a letter is later than the delivery date of the letter, it is clear that the latter was written in by mistake and should therefore be disregarded.

**ARTICLE 2.1.9**

*(Late acceptance. Delay in transmission)*

**(1) A late acceptance is nevertheless effective as an acceptance if without undue delay the offeror so informs the offeree or gives notice to that effect.**

**(2) If a communication containing a late acceptance shows that it has been sent in such circumstances that if its transmission had been normal it would have reached the offeror in due time, the late acceptance is effective as an acceptance unless, without undue delay, the offeror informs the offeree that it considers the offer as having lapsed.**

**COMMENT****1. Late acceptance normally ineffective**

According to the principle laid down in Article 2.1.7, for an acceptance to be effective it must reach the offeror within the time fixed by the latter or, if no time is fixed, within a reasonable time. This means that as a rule an acceptance which reaches the offeror thereafter is without effect and may be disregarded by the offeror.

## **2. Offeror may nevertheless “accept” late acceptance**

Paragraph (1) of this Article, which corresponds to Article 21 CISG, states that the offeror may nevertheless consider a late acceptance as having arrived in time and thus render it effective, provided that the offeror “without undue delay [...] so informs the offeree or gives notice to that effect”. If the offeror takes advantage of this possibility, the contract is to be considered as having been concluded as soon as the late acceptance reaches the offeror and not when the offeror informs the offeree of its intention to consider the late acceptance effective.

### **Illustration**

1. A indicates 31 March as the deadline for acceptance of its offer. B’s acceptance reaches A on 3 April. A, who is still interested in the contract, intends to “accept” B’s late acceptance, and immediately informs B of its intention. Notwithstanding the fact that this notice only reaches B on 5 April the contract is concluded on 3 April.

## **3. Acceptance late because of delay in transmission**

As long as the acceptance is late because the offeree did not send it in time, it is natural to consider it as having no effect unless the offeror expressly indicates otherwise. The situation is different when the offeree has replied in time, but the acceptance reaches the offeror late because of an unexpected delay in transmission. In such a case the reliance of the offeree on the acceptance having arrived in time deserves protection, with the consequence that the late acceptance is considered to be effective unless the offeror objects without undue delay. The only condition required by paragraph (2) is that the communication containing the late acceptance show that it was sent in such circumstances that, had its transmission been normal, it would have reached the offeror in due time.

### **Illustrations**

2. The facts are the same as in Illustration 1, except that B, knowing that the normal time for transmission of letters by mail to A is three days, sends its letter of acceptance on 25 March. Owing to a strike of the postal service in A’s country the letter, which shows the date of its mailing on the envelope, only arrives on 3 April. B’s acceptance, though late, is nevertheless effective unless A objects without undue delay.

3. The facts are the same as in Illustration 1, except that B, after receiving A's offer, accepts it on 30 March by e-mail. Due to technical problems at A's server, the e-mail reaches A only on 1 April. B's acceptance, though late, is nevertheless effective unless A objects without undue delay.

**ARTICLE 2.1.10**

*(Withdrawal of acceptance)*

**An acceptance may be withdrawn if the withdrawal reaches the offeror before or at the same time as the acceptance would have become effective.**

**COMMENT**

With respect to the withdrawal of an acceptance this Article lays down the same principle as that contained in Article 2.1.3 concerning the withdrawal of an offer, i.e. that the offeree may change its mind and withdraw the acceptance provided that the withdrawal reaches the offeror before or at the same time as the acceptance.

It should be noted that while the offeror is bound by the offer and may no longer change its mind once the offeree has dispatched the acceptance (see Article 2.1.4(1)), the offeree loses its freedom of choice only at a later stage, i.e. when the notice of acceptance reaches the offeror.

This Article corresponds to Article 22 CISG.

**ARTICLE 2.1.11**

*(Modified acceptance)*

**(1) A reply to an offer which purports to be an acceptance but contains additions, limitations or other modifications is a rejection of the offer and constitutes a counter-offer.**

**(2) However, a reply to an offer which purports to be an acceptance but contains additional or different terms which do not materially alter the terms of the offer constitutes an acceptance, unless the offeror, without undue delay, objects to the discrepancy. If the offeror does not object, the terms of the contract are the terms of the offer with the modifications contained in the acceptance.**

#### COMMENT

##### **1. Acceptance with modifications normally to be considered a counter-offer**

In commercial dealings it often happens that the offeree, while signifying to the offeror its intention to accept the offer (“acknowledgement of order”), nevertheless includes in its declaration terms additional to or different from those of the offer. Paragraph (1) of this Article provides that such a purported acceptance is as a rule to be considered a rejection of the offer and that it amounts to a counter-offer by the offeree, which the offeror may or may not accept either expressly or impliedly, e.g. by an act of performance.

##### **2. Modifications which do not alter the nature of the acceptance**

The principle according to which the acceptance must be the mirror image of the offer implies that even unimportant differences between the offer and the acceptance permit either party at a later stage to question the existence of the contract. In order to avoid such a result, which a party may well seek merely because market conditions have changed unfavourably, paragraph (2) provides for an exception to the general rule laid down in paragraph (1) by stating that if the additional or modified terms contained in the acceptance do not “materially” alter the terms of the offer, the contract is concluded with those modifications unless the offeror objects without undue delay.

What amounts to a “material” modification cannot be determined in the abstract but will depend on the circumstances of each case. Additional or different terms relating to the price or mode of payment, place and time of performance of a non-monetary obligation, the extent of one party’s liability to the other or the settlement of disputes, will normally, but need not necessarily, constitute a material modification

of the offer. An important factor to be taken into account in this respect is whether the additional or different terms are commonly used in the trade sector concerned and therefore do not come as a surprise to the offeror.

### Illustrations

1. A orders a machine from B to be tested on A's premises. In its acknowledgement of order B declares that it accepts the terms of the offer, but adds that it wishes to be present at the testing of the machine. The additional term is not a "material" modification of the offer and will therefore become part of the contract unless A objects without undue delay.
2. The facts are the same as in Illustration 1, except that in its acknowledgement of order B adds an arbitration clause. Unless the circumstances indicate otherwise, such a clause amounts to a "material" modification of the terms of the offer, with the result that B's purported acceptance would constitute a counter-offer.
3. A orders a stated quantity of wheat from B. In its acknowledgement of order B adds an arbitration clause which is standard practice in the commodity sector concerned. Since A cannot be surprised by such a clause, it is not a "material" modification of the terms of the offer and, unless A objects without undue delay, the arbitration clause becomes part of the contract.

### **ARTICLE 2.1.12**

*(Writings in confirmation)*

**If a writing which is sent within a reasonable time after the conclusion of the contract and which purports to be a confirmation of the contract contains additional or different terms, such terms become part of the contract, unless they materially alter the contract or the recipient, without undue delay, objects to the discrepancy.**

### **COMMENT**

#### **1. "Writings in confirmation"**

This Article deals with the situation where a contract has already been concluded either orally or by the exchange of written communications limited to the essential terms of the agreement, and



one party subsequently sends the other a document intended simply to confirm what has already been agreed upon, but which in fact contains terms which are additional to or different from those previously agreed by the parties. In theory, this situation clearly differs from that envisaged in Article 2.1.11, where a contract has not yet been concluded and the modifying terms are contained in the offeree's purported acceptance. Yet, since in practice it may be very difficult if not impossible to distinguish between the two situations, this Article adopts with respect to modifying terms contained in a writing in confirmation the same solution as that envisaged in Article 2.1.11. In other words, just as for the modifications contained in an acknowledgement of order, it is provided that terms additional to or different from those previously agreed by the parties contained in a writing in confirmation become part of the contract, provided that they do not "materially" alter the agreement and that the recipient of the document does not object to them without undue delay.

It goes without saying that also in the context of writings in confirmation the question of which of the new terms "materially" alter the terms of the previous agreement can be answered definitely only in the light of the circumstances of each individual case. On the other hand, this Article clearly does not apply to cases where the party sending the writing in confirmation expressly invites the other party to return it duly counter-signed for acceptance. In such circumstances it is irrelevant whether the writing contains modifications, and if so whether or not these modifications are "material" since the writing must in any case be expressly accepted by the addressee if there is to be a contract.

### Illustrations

1. A orders by telephone a machine from B, who accepts the order. The following day A receives a letter from B confirming the terms of their oral agreement but adding that B wishes to be present at the testing of the machine on A's premises. The additional term is not a "material" modification of the terms previously agreed between the parties and will therefore become part of the contract unless A objects without undue delay.
2. The facts are the same as in Illustration 1, except that the modification contained in B's writing in confirmation consists in the addition of an arbitration clause. Unless the circumstances indicate otherwise such a clause amounts to a "material" modification of the terms previously agreed between the parties with the result that it will not become part of the contract.

3. A orders by e-mail a stated quantity of wheat and B accepts immediately by e-mail. Later on the same day B sends a letter to A confirming the terms of their agreement but adding an arbitration clause which is standard practice in the commodity sector concerned. Since A cannot be surprised by such a clause, it is not a “material” modification of the terms previously agreed and, unless A objects without undue delay, the arbitration clause becomes part of the contract.

## **2. Writing in confirmation to be sent within a reasonable time after conclusion of the contract**

The rule according to which silence on the part of the recipient amounts to acceptance of the content of the writing in confirmation, including any non-material modifications of the terms previously agreed, presupposes that the writing is sent “within a reasonable time after the conclusion of the contract”. Any writing of this kind sent after a period of time which, in the circumstances, appears to be unreasonably long, loses any significance, and silence on the part of the recipient may therefore no longer be interpreted as acceptance of its content.

## **3. Invoices**

For the purposes of this Article, the term “writing in confirmation” is to be understood in a broad sense, i.e. as covering also those cases where a party uses the invoice or another similar document relating to performance to specify the conditions of the contract concluded either orally or by informal correspondence, provided that such use is customary in the trade sector and/or country concerned.

### **ARTICLE 2.1.13**

*(Conclusion of contract dependent on agreement on specific matters or in a particular form)*

**Where in the course of negotiations one of the parties insists that the contract is not concluded until there is agreement on specific matters or in a particular form, no contract is concluded before agreement is reached on those matters or in that form.**

**COMMENT****1. Conclusion of contract dependent on agreement on specific matters**

As a rule, a contract is concluded if the parties reach agreement on the terms which are essential to the type of transaction involved, while minor terms which the parties have not settled may subsequently be implied either in fact or by law (see Comment 1 on Article 2.1.2 and also Articles 4.8 and 5.1.2).

**Illustration**

1. A agrees with B on all the terms which are essential to their intended contract for the distribution of A's goods. When the question subsequently arises of who should bear the costs of the publicity campaign, neither party may claim that no contract has come into existence by reason of the silence of the contract on this point, as the missing term is not essential to the type of transaction in question and will be implied in fact or by law.

Parties may, however, in a given case consider specific matters to be of such importance that they do not intend to enter into a binding agreement unless these matters are settled in a satisfactory manner. If the parties, or one only of them, make such an intention explicit, the contract as such does not come into existence without agreement on those matters. By using the word “insists”, this Article makes it clear that it is not sufficient for the parties to manifest their intention to this effect simply in passing, but that it must be done unequivocally.

**Illustration**

2. The facts are the same as in Illustration 1, except that during the negotiations B repeatedly declares that the question of who should bear the cost of the publicity campaign must be settled expressly. Notwithstanding their agreement on all the essential terms of the contract, no contract has come into existence between A and B since B had insisted that the conclusion of the contract was dependent on agreement regarding that specific term.

**2. Conclusion of contract dependent on agreement in a particular form**

In commercial practice, particularly when transactions of considerable complexity are involved, it is quite frequent that after prolonged negotiations the parties sign an informal document called

“Preliminary Agreement”, “Memorandum of Understanding”, “Letter of Intent” or the like, containing the terms of the agreement so far reached, but at the same time state their intention to provide for the execution of a formal document at a later stage (“Subject to Contract”, “Formal Agreement to follow”). In some cases the parties consider their contract as already being concluded and the execution of the formal document only as confirmation of the already complete agreement. If, however, both parties, or only one of them, make it clear that they do not intend to be bound unless the formal document has been drawn up, there will be no contract until that time even if the parties have agreed on all the relevant aspects of their transaction.

### **Illustrations**

3. After prolonged negotiations A and B sign a “Memorandum of Understanding” containing the terms of an agreement for a joint venture for the exploration and exploitation of the continental shelf of country X. The parties agree that they will at a later stage draw up the agreement in formal documents to be signed and exchanged at a public ceremony. If the “Memorandum” already contains all the relevant terms of the agreement and the subsequent documents are intended merely to permit the agreement to be properly presented to the public, it may be taken that the contract was already concluded when the first written document was signed.
4. The facts are the same as in Illustration 3, except that the “Memorandum of Understanding” contains a clause such as “Not binding until final agreement is executed” or the like. Until the signing and the exchange of the formal documents there is no binding contract.

### **ARTICLE 2.1.14**

*(Contract with terms deliberately left open)*

- (1) If the parties intend to conclude a contract, the fact that they intentionally leave a term to be agreed upon in further negotiations or to be determined by a third person does not prevent a contract from coming into existence.**
- (2) The existence of the contract is not affected by the fact that subsequently**
  - (a) the parties reach no agreement on the term; or**

**(b) the third person does not determine the term,  
provided that there is an alternative means of rendering the term definite that is reasonable in the circumstances, having regard to the intention of the parties.**

## **COMMENT**

### **1. Contract with terms deliberately left open**

A contract may be silent on one or more issues because the parties simply did not think of them during the negotiations. Provided that the parties have agreed on the terms essential to the type of transaction concerned, a contract will nonetheless have been concluded and the missing terms will be supplied on the basis of Articles 4.8 or 5.1.2 (see Comment 1 on Article 2.1.2). Quite different is the case dealt with in this Article: here the parties intentionally leave open one or more terms because they are unable or unwilling to determine them at the time of the conclusion of the contract, and refer for their determination to an agreement to be made by them at a later stage, or to a third person.

This latter situation, which is especially frequent in, although not confined to, long-term transactions, gives rise in essence to two problems: first, whether the fact that the parties have intentionally left terms open prevents a contract from coming into existence and second, if this is not the case, what will happen to the contract if the parties subsequently fail to reach agreement or the third person fails to make the determination.

### **2. Open terms not in themselves an impediment to valid conclusion of contract**

Paragraph (1) states that if the parties intended to conclude a contract, the fact that they have intentionally left a term to be agreed upon in further negotiations or to be determined by a third person does not prevent a contract from coming into existence.

In cases where it is not expressly stated, the parties' intention to conclude a contract notwithstanding the terms left open may be inferred from other circumstances, such as the non-essential character of the terms in question, the degree of definiteness of the agreement as a whole, the fact that the open terms relate to items which by their very nature can be determined only at a later stage, the fact that the agreement has already been partially executed, etc.

**Illustration**

1. A, a shipping line, enters into a detailed agreement with B, a terminal operator, for the use of B's container terminal. The agreement fixes the minimum volume of containers to be discharged or loaded annually and the fees payable, while the fees for additional containers are left to be determined if and when the minimum volume is reached. Two months later A learns that B's competitor would offer better conditions and refuses to perform, claiming that the agreement with B never resulted in a binding contract because the question of the fees had not been settled. A is liable for non-performance because the detailed character of the agreement as well as the fact that both A and B began performance immediately indicate clearly that their intention was to enter into a binding agreement.

**3. Failure of mechanism provided for by parties for determination of open terms**

If the parties are unable to reach agreement on the open terms or the third person does not determine them, the question arises as to whether or not the contract comes to an end. According to paragraph (2) of this Article the existence of the contract is not affected "provided that there is an alternative means of rendering the term definite that is reasonable in the circumstances, having regard to the intention of the parties". A first alternative exists whenever the missing term can be supplied on the basis of Article 5.1.2; if the parties have deferred the determination of the missing term to a third person to be nominated by an instance such as the President of the Tribunal, or of the Chamber of Commerce, etc., it may also consist in the appointment of a new third person. The cases in which a given contract may be upheld by resorting to such alternative means will, however, be quite rare in practice. Few problems should arise as long as the term to be implemented is of minor importance. If, on the other hand, the term in question is essential to the type of transaction concerned, there must be clear evidence of the intention of the parties to uphold the contract: among the factors to be taken into account in this connection are whether the term in question relates to items which by their very nature can be determined only at a later stage, whether the agreement has already been partially executed, etc.

### Illustration

2. The facts are the same as in Illustration 1, except that when the minimum volume of containers to be loaded or unloaded is reached the parties fail to agree on the fees payable in respect of the additional containers. A stops performing, claiming that the contract has come to an end. A is liable for non-performance, since the fact that the parties have started performing without making future agreement on the missing term a condition for the continuation of their business relationship is sufficient evidence of their intention to uphold the contract even in the absence of such agreement. The fees for the additional containers will be determined according to the criteria laid down in Article 5.1.7.

### ARTICLE 2.1.15

*(Negotiations in bad faith)*

**(1) A party is free to negotiate and is not liable for failure to reach an agreement.**

**(2) However, a party who negotiates or breaks off negotiations in bad faith is liable for the losses caused to the other party.**

**(3) It is bad faith, in particular, for a party to enter into or continue negotiations when intending not to reach an agreement with the other party.**

### COMMENT

#### 1. Freedom of negotiation

As a rule, parties are not only free to decide when and with whom to enter into negotiations with a view to concluding a contract, but also if, how and for how long to proceed with their efforts to reach an agreement. This follows from the basic principle of freedom of contract enunciated in Article 1.1, and is essential in order to guarantee healthy competition among business people engaged in international trade.

**2. Liability for negotiating in bad faith**

A party's right freely to enter into negotiations and to decide on the terms to be negotiated is, however, not unlimited, and must not conflict with the principle of good faith and fair dealing laid down in Article 1.7. One particular instance of negotiating in bad faith which is expressly indicated in paragraph (3) of this Article is that where a party enters into negotiations or continues to negotiate without any intention of concluding an agreement with the other party. Other instances are where one party has deliberately or by negligence misled the other party as to the nature or terms of the proposed contract, either by actually misrepresenting facts, or by not disclosing facts which, given the nature of the parties and/or the contract, should have been disclosed. As to the duty of confidentiality, see Article 2.1.16.

A party's liability for negotiating in bad faith is limited to the losses caused to the other party (paragraph (2)). In other words, the aggrieved party may recover the expenses incurred in the negotiations and may also be compensated for the lost opportunity to conclude another contract with a third person (so-called reliance or negative interest), but may generally not recover the profit which would have resulted had the original contract been concluded (so-called expectation or positive interest).

Only if the parties have expressly agreed on a duty to negotiate in good faith, will all the remedies for breach of contract be available to them, including the remedy of the right to performance.

**Illustrations**

1. A learns of B's intention to sell its restaurant. A, who has no intention whatsoever of buying the restaurant, nevertheless enters into lengthy negotiations with B for the sole purpose of preventing B from selling the restaurant to C, a competitor of A's. A, who breaks off negotiations when C has bought another restaurant, is liable to B, who ultimately succeeds in selling the restaurant at a lower price than that offered by C, for the difference in price.
2. A, who is negotiating with B for the promotion of the purchase of military equipment by the armed forces of B's country, learns that B will not receive the necessary import licence from its own governmental authorities, a pre-requisite for permission to pay B's fees. A does not reveal this fact to B and finally concludes the contract, which, however, cannot be enforced by reason of the missing licences. A is liable to B for the costs incurred after A had learned of the impossibility of obtaining the required licence.



3. A enters into lengthy negotiations for a bank loan from B's branch office. At the last minute the branch office discloses that it had no authority to sign and that its head office has decided not to approve the draft agreement. A, who could in the meantime have obtained the loan from another bank, is entitled to recover the expenses entailed by the negotiations and the profits it would have made during the delay before obtaining the loan from the other bank.

4. Contractor A and supplier B enter into a pre-bid agreement whereby they undertake to negotiate in good faith for the supply of equipment in the event that A succeeds in becoming prime contractor for a major construction project. A is awarded the construction contract, but after preliminary contacts with B refuses to continue the negotiations. B may request enforcement of the duty to negotiate in good faith.

### **3. Liability for breaking off negotiations in bad faith**

The right to break off negotiations also is subject to the principle of good faith and fair dealing. Once an offer has been made, it may be revoked only within the limits provided for in Article 2.1.4. Yet even before this stage is reached, or in a negotiation process with no ascertainable sequence of offer and acceptance, a party may no longer be free to break off negotiations abruptly and without justification. When such a point of no return is reached depends on the circumstances of the case, in particular the extent to which the other party, as a result of the conduct of the first party, had reason to rely on the positive outcome of the negotiations, and on the number of issues relating to the future contract on which the parties have already reached agreement.

#### **Illustration**

5. A assures B of the grant of a franchise if B takes steps to gain experience and is prepared to invest USD 300,000. During the next two years B makes extensive preparations with a view to concluding the contract, always with A's assurance that B will be granted the franchise. When all is ready for the signing of the agreement, A informs B that the latter must invest a substantially higher sum. B, who refuses, is entitled to recover from A the expenses incurred with a view to the conclusion of the contract.

**ARTICLE 2.1.16**  
*(Duty of confidentiality)*

**Where information is given as confidential by one party in the course of negotiations, the other party is under a duty not to disclose that information or to use it improperly for its own purposes, whether or not a contract is subsequently concluded. Where appropriate, the remedy for breach of that duty may include compensation based on the benefit received by the other party.**

**COMMENT**

**1. Parties in general not under a duty of confidentiality**

Just as there exists no general duty of disclosure, so parties, when entering into negotiations for the conclusion of a contract, are normally under no obligation to treat the information they have exchanged as confidential. In other words, since a party is normally free to decide which facts relevant to the transaction under negotiation to disclose, such information is as a rule to be considered non-confidential, i.e. information which the other party may either disclose to third persons or use for purposes of its own should no contract be concluded.

**Illustration**

1. A invites B and C, producers of air-conditioning systems, to submit offers for the installation of such a system. In their offers B and C also provide some technical details regarding the functioning of their respective systems, with a view to enhancing the merits of their products. A decides to reject B's offer and to continue negotiations only with C. A is free to use the information contained in B's offer in order to induce C to propose more favourable conditions.

**2. Confidential information**

A party may have an interest in certain information given to the other party not being divulged or used for purposes other than those for which it was given. As long as that party expressly declares that such information is to be considered confidential, the situation is clear,

for by receiving the information the other party implicitly agrees to treat it as confidential. The only problem which may arise is that if the period during which the other party is not to disclose the information is too long, this might contravene the applicable laws prohibiting restrictive trade practices. Yet even in the absence of such an express declaration the receiving party may be under a duty of confidentiality. This is the case where, in view of the particular nature of the information or the professional qualifications of the parties, it would be contrary to the general principle of good faith and fair dealing for the receiving party to disclose it, or to use it for its own purposes after the breaking off of negotiations.

### Illustrations

2. The facts are the same as in Illustration 1, except that in its offer B expressly requests A not to divulge certain technical specifications contained therein. A may not use this information in its negotiations with C.
3. A is interested in entering into a joint venture agreement with B or C, the two leading car manufacturers in country X. Negotiations progress with B in particular, and A receives fairly detailed information relating to B's plans for a new car design. Although B does not expressly request A to treat this information as confidential, because it is for a new car design. A may be under a duty not to disclose it to C, nor is A allowed to use those plans for its own production process should the negotiations not result in the conclusion of a contract.

### 3. Damages recoverable

The breach of confidentiality implies first liability in damages. The amount of damages recoverable may vary, depending on whether or not the parties entered into a special agreement for the non-disclosure of the information. Even if the injured party has not suffered any loss, it may be entitled to recover from the non-performing party the benefit the latter received by disclosing the information to third persons or by using it for its own purposes. If necessary, for example when the information has not yet been disclosed or has been disclosed only partially, the injured party may also seek an injunction in accordance with the applicable law.

**ARTICLE 2.1.17***(Merger clauses)*

**A contract in writing which contains a clause indicating that the writing completely embodies the terms on which the parties have agreed cannot be contradicted or supplemented by evidence of prior statements or agreements. However, such statements or agreements may be used to interpret the writing.**

**COMMENT**

If the conclusion of a contract is preceded by more or less extended negotiations, the parties may wish to put their agreement in writing and declare that document to constitute their final agreement. This can be achieved by an appropriately drafted “merger” or “integration” clause (e.g. “This contract contains the entire agreement between the parties”). However, the effect of such a clause is not to deprive prior statements or agreements of any relevance: they may still be used as a means of interpreting the written document (see also Article 4.3(a)).

A merger clause of course covers only prior statements or agreements between the parties and does not preclude subsequent informal agreements between them. The parties are, however, free to extend an agreed form even to future amendments (see Article 2.1.18).

This Article indirectly confirms the principle set out in Article 1.2 in the sense that, in the absence of a merger clause, extrinsic evidence supplementing or contradicting a written contract is admissible.

**ARTICLE 2.1.18***(Modification in a particular form)*

**A contract in writing which contains a clause requiring any modification or termination by agreement to be in a particular form may not be otherwise modified or terminated. However, a party may be precluded by its conduct from asserting such a clause to the extent that the other party has reasonably acted in reliance on that conduct.**

**COMMENT**

Parties concluding a written contract may wish to ensure that any modification or termination by agreement will also be in writing or otherwise in a particular form and to this end include a special clause in the contract (e.g. “Any modification of this Contract may be made only by a writing signed by both Parties”; “Alterations to the above-indicated Time-schedule must be confirmed in writing by the Engineer’s representative on site”).

This Article states that as a rule such a clause renders ineffective any modification or termination by agreement not in the particular form required.

**Illustration**

1. Contractor A contracts with purchaser B for the construction of a building. The contract provides that any modification to the work schedule must be in writing and the document must be signed by both parties. In the course of construction, A sends B an e-mail asking B to agree to the extension of a particular deadline. B accepts by return of e-mail. The modification is ineffective since there is no single document bearing both parties’ signature.

Yet there is an exception to the general rule. In application of the general principle prohibiting inconsistent behaviour (see Article 1.8), this Article specifies that a party may be precluded by its conduct from invoking the clause requiring any modification or termination to be in a particular form to the extent that the other party has reasonably acted in reliance on that conduct.

**Illustration**

2. A, a contractor, contracts with B, a school board, for the construction of a new school building. The contract provides that the second floor of the building is to have sufficient bearing capacity to support the school library. Notwithstanding a “no oral modification” clause in the same contract, the parties orally agree that the second floor of the building should be of non-bearing construction. A completes construction according to the modification and B, who has observed the progress of the construction without making any objections, only at this point objects to how the second floor has been constructed. A court may decide that B is not entitled to invoke the “no oral modification” clause as A reasonably relied on the oral modification, and is therefore not liable for non-performance.

**ARTICLE 2.1.19**

*(Contracting under standard terms)*

**(1) Where one party or both parties use standard terms in concluding a contract, the general rules on formation apply, subject to Articles 2.1.20 – 2.1.22.**

**(2) Standard terms are provisions which are prepared in advance for general and repeated use by one party and which are actually used without negotiation with the other party.**

**COMMENT****1. Contracting under standard terms**

This Article is the first of four articles (Articles 2.1.19 – 2.1.22) which deal with the special situation where one or both parties use standard terms in concluding a contract.

**2. Notion of “standard terms”**

“Standard terms” are to be understood as those contract provisions which are prepared in advance for general and repeated use by one party and which are actually used without negotiation with the other party (paragraph (2)). What is decisive is not their formal presentation (e.g. whether they are contained in a separate document or in the contract document itself; whether they have been issued on pre-printed forms or are only contained in an electronic file, etc.), nor who prepared them (the party itself, a trade or professional association, etc.), nor their volume (whether they consist of a comprehensive set of provisions covering almost all the relevant aspects of the contract, or of only one or two provisions regarding, for instance, exclusion of liability and arbitration). What is decisive is the fact that they are drafted in advance for general and repeated use and that they are actually used in a given case by one of the parties without negotiation with the other party. This latter requirement obviously relates only to the standard terms as such, which the other party must accept as a whole, while the other terms of the same contract may well be the subject of negotiation between the parties.

### 3. General rules on formation apply

Usually, the general rules on formation apply irrespective of whether or not one or both parties use standard terms (paragraph (1)). It follows that standard terms proposed by one party bind the other party only on acceptance, and that it depends upon the circumstances of the case whether the two parties must refer to the standard terms expressly or whether the incorporation of such terms may be implied. Thus, standard terms contained in the contract document itself will normally be binding upon the mere signature of the contract document as a whole, at least as long as they are reproduced above that signature and not, for instance, on the reverse side of the document. On the other hand, standard terms contained in a separate document or electronic file will normally have to be referred to expressly by the party intending to use them. Implied incorporation may be admitted only if there exists a practice established between the parties or usage to that effect (see Article 1.9).

#### Illustrations

1. A intends to conclude an insurance contract with B covering the risk of liability for accidents of A's employees at work. The parties sign a model contract form presented by B after filling in the blank spaces relating, among other matters, to the premium and to the maximum amount insured. By virtue of its signature, A is bound not only by the terms which it has individually negotiated with B, but also by the General Conditions of the National Insurers' Association, which are printed on the form.
2. A normally concludes contracts with its customers on the basis of its own standard terms which are printed as a separate document. When making an offer to B, a new customer, A fails to make an express reference to the standard terms. B accepts the offer. The standard terms are not incorporated in the contract unless A can prove that B knew or ought to have known of A's intention to conclude the contract only on the basis of its own standard terms, e.g. because the same standard terms had regularly been adopted in previous transactions.
3. A intends to buy grain on the commodity exchange in London. In the contract concluded between A and B, a broker on that exchange, no express reference is made to the standard terms which normally govern brokerage contracts concluded at the exchange in question. The standard terms are nevertheless incorporated in the contract because their application to the kind of contract in question amounts to a usage.

**ARTICLE 2.1.20***(Surprising terms)*

**(1) No term contained in standard terms which is of such a character that the other party could not reasonably have expected it, is effective unless it has been expressly accepted by that party.**

**(2) In determining whether a term is of such a character regard shall be had to its content, language and presentation.**

**COMMENT****1. Surprising terms in standard terms not effective**

A party which accepts the other party's standard terms is in principle bound by them irrespective of whether or not it actually knows their content in detail or fully understands their implications. An important exception to this rule is, however, laid down in this Article which states that, notwithstanding its acceptance of the standard terms as a whole, the adhering party is not bound by those terms which by virtue of their content, language or presentation are of such a character that it could not reasonably have expected them. The reason for this exception is the desire to avoid a party which uses standard terms taking undue advantage of its position by surreptitiously attempting to impose terms on the other party which that party would scarcely have accepted had it been aware of them. For other articles intended to protect the economically weaker or less experienced party, see Articles 3.2.7 and 4.6.

**2. Terms "surprising" by virtue of their content**

A particular term contained in standard terms may come as a surprise to the adhering party first by reason of its content. This is the case whenever the content of the term in question is such that a reasonable person of the same kind as the adhering party would not have expected it in the type of standard terms involved. In determining whether or not a term is unusual, regard must be had on the one hand to the terms which are commonly to be found in standard terms generally used in the trade sector concerned, and on the other to the individual negotiations between the parties. Thus, for example, a term excluding or limiting the contractual liability of the proponent may or may not be



considered to be “surprising”, and in consequence ineffective in a particular case, its effectiveness depending on whether or not terms of that kind are common in the trade sector concerned, and are consistent with the way in which the parties conducted their negotiations.

#### Illustration

1. A, a travel agency, offers package tours for business trips. The terms of the advertisement give the impression that A is acting as a tour operator who undertakes full responsibility for the various services comprising the package. B books a tour on the basis of A’s standard terms. Notwithstanding B’s acceptance of the terms as a whole, A may not rely on a term stating that, with respect to the hotel accommodation, it is acting merely as an agent for the hotelkeeper, and therefore declines any liability.

### 3. Terms “surprising” by virtue of their language or presentation

Other reasons for a particular term contained in standard terms being surprising to the adhering party may be the language in which it is couched, which may be obscure, or the way in which it is presented typographically, for instance in minute print. In order to determine whether or not this is the case, regard is to be had not so much to the formulation and presentation commonly used in the type of standard terms involved, but more to the professional skill and experience of persons of the same kind as the adhering party. Thus, a particular wording may be both obscure and clear at the same time, depending on whether or not the adhering party belongs to the same professional category as the party using the standard terms.

The language factor may also play an important role in the context of international transactions. If the standard terms are drafted in a foreign language it cannot be excluded that some of its terms, although fairly clear in themselves, will turn out to be surprising for the adhering party who could not reasonably have been expected fully to appreciate all their implications.

#### Illustrations

2. A, an insurance company operating in country X, is an affiliate of B, a company incorporated in country Y. A’s standard terms comprise some 50 terms printed in small type. One of the terms designates the law of country Y as the applicable law. Unless this term is presented in bold letters or in any other way apt to attract the attention of the adhering party, it will be without effect

since customers in country X would not reasonably expect to find a choice-of-law clause designating a foreign law as the law governing their contracts in the standard terms of a company operating in their own country.

3. A, a commodity dealer operating in Hamburg, uses in its contracts with its customers standard terms containing, among others, a provision stating “Hamburg – Freundschaftliche Arbitrage”. In local business circles this clause is normally understood as meaning that possible disputes are to be submitted to a special arbitration governed by particular rules of procedure of local origin. In contracts with foreign customers this clause may be held to be ineffective, notwithstanding the acceptance of the standard terms as a whole, since a foreign customer cannot reasonably be expected to understand its exact implications, and this irrespective of whether or not the clause has been translated into the foreign customer’s own language.

#### **4. Express acceptance of “surprising” terms**

The risk of the adhering party being taken by surprise by the kind of terms so far discussed clearly no longer exists if in a given case the other party draws the adhering party’s attention to them and the adhering party accepts them. This Article therefore provides that a party may no longer rely on the “surprising” nature of a term in order to challenge its effectiveness, once it has expressly accepted the term.

#### **ARTICLE 2.1.21**

*(Conflict between standard terms  
and non-standard terms)*

**In case of conflict between a standard term  
and a term which is not a standard term the latter  
prevails.**

#### **COMMENT**

Standard terms are by definition prepared in advance by one party or a third person and incorporated in an individual contract without their content being discussed by the parties (see Article 2.1.19(2)). It is therefore logical that whenever the parties specifically negotiate and agree on particular provisions of their contract, such provisions will prevail over conflicting provisions contained in the standard terms

since they are more likely to reflect the intention of the parties in the given case.

The individually agreed provisions may appear in the same document as the standard terms, but may also be contained in a separate document. In the first case they may easily be recognised on account of their being written in characters different from those of the standard terms. In the second case it may be more difficult to distinguish between the provisions which are standard terms and those which are not, and to determine their exact position in the hierarchy of the different documents. To this effect the parties often include a contract provision expressly indicating the documents which form part of their contract and their respective weight. Special problems may however arise when the modifications to the standard terms have only been agreed upon orally, without the conflicting provisions contained in the standard terms being struck out, and those standard terms contain a provision stating the exclusive character of the writing signed by the parties, or that any addition to or modification of their content must be in writing. For these cases see Articles 2.1.17 and 2.1.18.

#### ARTICLE 2.1.22

*(Battle of forms)*

**Where both parties use standard terms and reach agreement except on those terms, a contract is concluded on the basis of the agreed terms and of any standard terms which are common in substance unless one party clearly indicates in advance, or later and without undue delay informs the other party, that it does not intend to be bound by such a contract.**

#### COMMENT

##### **1. Parties using different standard terms**

It is quite frequent in commercial transactions for both the offeror when making the offer, and the offeree when accepting it, each to refer to its own standard terms. In the absence of express acceptance by the offeror of the offeree's standard terms, the problem arises as to whether a contract is concluded at all and if so, which, if either, of the two conflicting sets of standard terms should prevail.

## 2. “Battle of forms” and general rules on offer and acceptance

If the general rules on offer and acceptance were to be applied, there would either be no contract at all since the purported acceptance by the offeree would, subject to the exception provided for in Article 2.1.11(2), amount to a counter-offer, or if the two parties have started to perform without objecting to each other’s standard terms, a contract would be considered to have been concluded on the basis of those terms which were the last to be sent or to be referred to (the “last shot”).

## 3. The “knock-out” doctrine

The “last shot” doctrine may be appropriate if the parties clearly indicate that the adoption of their standard terms is an essential condition for the conclusion of the contract. Where, on the other hand, the parties, as is very often the case in practice, refer to their standard terms more or less automatically, for example by exchanging printed order and acknowledgement of order forms with the respective terms on the reverse side, they will normally not even be aware of the conflict between their respective standard terms. There is in such cases no reason to allow the parties subsequently to question the very existence of the contract or, if performance has commenced, to insist on the application of the terms last sent or referred to.

It is for this reason that this Article provides, notwithstanding the general rules on offer and acceptance, that if the parties reach an agreement except on their standard terms, a contract is concluded on the basis of the agreed terms and of any standard terms which are common in substance (“knock-out” doctrine).

### Illustration

1. A orders a machine from B indicating the type of machine, the price and terms of payment, and the date and place of delivery. A uses an order form with its “General Conditions for Purchase” printed on the reverse side. B accepts by sending an acknowledgement of order form on the reverse side of which appear its own “General Conditions for Sale”. When A subsequently seeks to withdraw from the deal it claims that no contract was ever concluded as there was no agreement as to which set of standard terms should apply. Since, however, the parties have agreed on the essential terms of the contract, a contract has been concluded on those terms and on any standard terms which are common in substance.

A party may, however, always exclude the operation of the “knock-out” doctrine by clearly indicating in advance, or by later and without undue delay informing the other, that it does not intend to be bound by a

contract which is not based on its own standard terms. What will in practice amount to such a “clear” indication cannot be stated in absolute terms but the inclusion of a clause of this kind in the standard terms themselves will not normally be sufficient since what is necessary is a specific declaration by the party concerned in its offer or acceptance.

### Illustrations

2. The facts are the same as in Illustration 1, except that A claims that the contract was concluded on the basis of its standard terms since they contain a clause which states that “Deviating standard terms of the party accepting the order are not valid if they have not been confirmed in writing by us”. The result will be the same as in Illustration 1, since merely by including such a clause in its standard terms A does not indicate with sufficient clarity its determination to conclude the contract only on its own terms.

3. The facts are the same as in Illustration 1, except that the non-standard terms of A’s offer contain a statement to the effect that A intends to contract only on its own standard terms. The mere fact that B attaches its own standard terms to its acceptance does not prevent the contract from being concluded on the basis of A’s standard terms.

## **SECTION 2: AUTHORITY OF AGENTS**

### **ARTICLE 2.2.1**

*(Scope of the Section)*

**(1) This Section governs the authority of a person (“the agent”) to affect the legal relations of another person (“the principal”) by or with respect to a contract with a third party, whether the agent acts in its own name or in that of the principal.**

**(2) It governs only the relations between the principal or the agent on the one hand, and the third party on the other.**

**(3) It does not govern an agent’s authority conferred by law or the authority of an agent appointed by a public or judicial authority.**

### **COMMENT**

#### **1. Scope of the Section**

This Section governs the authority of an agent to affect the legal relations between its principal and a third party. In other words, it focuses on the external relations between the principal or the agent on the one hand and the third party on the other and is not concerned with the internal relations between the principal and the agent. Even those provisions which deal with issues affecting both the internal and the external relations (see, e.g., Articles 2.2.2 and 2.2.10 on the establishment and termination of the agent’s authority, Article 2.2.7 on conflict of interests and Article 2.2.8 on sub-agency), consider those issues only with respect to their effects on the third party.

The rights and duties as between principal and agent are governed by their agreement and the applicable law which, with respect to specific types of agency relationships such as those concerning so-called “commercial agents”, may provide mandatory rules for the protection of the agent.

#### **2. Authority to contract**

The Section deals only with agents who have authority to conclude contracts on behalf of their principals. Intermediaries whose task it is

merely to introduce two parties to one another with a view to their concluding a contract (e.g. real estate agents), or to negotiate contracts on behalf of a principal but who have no authority to bind the principal (as may be the case of commercial agents) are outside the scope of the Section.

On the other hand, the wording “the authority [...] to affect the legal relations of [...] the principal by or with respect to a contract with a third party” used in paragraph (1) is to be understood in a broad sense, so as to comprise any act by the agent aimed at concluding a contract or which relates to its performance, including giving a notice to, or receiving it from, the third party.

### **3. Irrelevant whether agent acts in its own name or in that of its principal**

Contrary to a number of legal systems that distinguish between “direct representation” and “indirect representation” depending on whether the agent acts in the principal’s name or in its own name, no such distinction is made in this Section. As to the distinction between “disclosed” and “undisclosed” agency, see Articles 2.2.3 and 2.2.4.

### **4. Voluntary nature of the relationship between principal and agent**

A further condition for the application of this Section is the voluntary nature of the relationship between principal and agent. Cases where the agent’s authority is conferred by law (e.g. in the field of family law, matrimonial property and succession), or is derived from judicial authorisation (e.g. acting for a person without capacity to act), are outside the scope of this Section.

### **5. Agents of companies**

The authority of organs, officers or partners of a corporation, partnership or other entity, with or without legal personality, is traditionally governed by special rules, sometimes even of a mandatory character, which by virtue of their specific scope necessarily prevail over the general rules on the authority of agents laid down in this Section. Thus, for instance, if under the special rules governing the authority of its organs or officers a corporation is prevented from invoking any limitation to their authority against third parties, that corporation may not rely on Article 2.2.5(1) to claim that it is not bound by an act of its organs or officers that falls outside the scope of their authority.

On the other hand, as long as the general rules laid down in this Section do not conflict with the above-mentioned special rules on the authority of organs, officers or partners, they may well be applied in lieu of the latter. Thus, for instance, a third party seeking to demonstrate that the contract it has concluded with an officer of a corporation binds that corporation, may invoke either the special rules governing the authority of that corporation's organs or officers or, as the case may be, the general rules on apparent authority laid down in Article 2.2.5(2).

### Illustrations

1. A, a Chief Executive Officer of company B incorporated in country X, has under the company's articles authority to carry out all transactions falling within the company's ordinary course of business. A enters into a contract with C that clearly falls outside the scope of B's ordinary business. According to Section 35A of the Companies Act of country X, "[i]n favour of a person dealing with a company in good faith, the power of the Board of Directors to bind the company, or authorise others to do so, shall be deemed to be free of any limitation under the company's constitution" and "[...] a person shall not be regarded as acting in bad faith by reason only of that person's knowing that an act is beyond the powers of the directors under the company's constitution [...]". B is bound by the contract between A and C even if C knew or ought to have known of the limitations to A's authority, and B may not rely on Article 2.2.5(1) to claim the contrary.

2. A, Managing Director of company B incorporated in country X, has been given by the Board of Directors of the company the authority to carry out all transactions falling within the company's ordinary course of business except the hiring and dismissal of employees. A hires C as the new accountant of B's branch in country Y. B refuses to be bound by this appointment on account of A's lack of authority to hire employees. C may overcome B's objection by invoking Section 35A of the Companies Act of country X. Yet C, who as a national of country Y may not be familiar with that special provision of the Companies Act of country X, may equally rely on the general rule on apparent authority laid down in Article 2.2.5(2) and claim that, in view of A's position as Managing Director of B, it was reasonable for C to believe that A had the authority to hire employees.



**ARTICLE 2.2.2**

*(Establishment and scope of the  
authority of the agent)*

- (1) The principal's grant of authority to an agent may be express or implied.**
- (2) The agent has authority to perform all acts necessary in the circumstances to achieve the purposes for which the authority was granted.**

**COMMENT**

**1. Express or implied grant of authority**

Paragraph (1) makes it clear that the granting of authority to the agent by the principal is not subject to any particular requirement of form and that it may be either express or implied.

The most common case of express authority is a power of attorney, but the principal may also confer authority on the agent in an oral statement or written communication or, in the case of a corporate entity, in a resolution by its board of directors. The granting of express authority in writing has the obvious advantage of providing clear evidence of the existence and precise scope of the agent's authority to all parties concerned (principal, agent and third parties).

An implied authority exists whenever the principal's intention to confer authority on an agent can be inferred from the principal's conduct (e.g. the assigning of a particular task to the agent) or other circumstances of the case (e.g. the terms of the express authorisation, a particular course of dealing between the two parties or a general trade usage).

**Illustration**

- 1. B appoints A as Manager of B's apartment building. A has implied authority to conclude short term lease contracts relating to the individual apartments.

**2. Scope of the authority**

The broader the mandate conferred on the agent, the broader the scope of its authority. Accordingly, paragraph (2) makes it clear that the agent's authority, unless otherwise provided by the principal in its authorisation, is not limited to its express terms, but extends to all acts

necessary in the circumstances to achieve the purposes for which the authority was granted.

### **Illustration**

2. Owner B consigns to shipmaster A a cargo to be carried to country X within 10 days. With only three days of navigation left, the ship is damaged and must stop in the nearest port for repairs. A has implied authority to unload the cargo and consign it to another shipmaster to be carried to destination on another ship.

### **ARTICLE 2.2.3**

*(Agency disclosed)*

**(1) Where an agent acts within the scope of its authority and the third party knew or ought to have known that the agent was acting as an agent, the acts of the agent shall directly affect the legal relations between the principal and the third party and no legal relation is created between the agent and the third party.**

**(2) However, the acts of the agent shall affect only the relations between the agent and the third party, where the agent with the consent of the principal undertakes to become the party to the contract.**

### **COMMENT**

#### **1. “Disclosed” agency**

With respect to the effects of the acts of the agent, this Section distinguishes between two basic situations: one in which the agent acts on behalf of a principal and within the scope of its authority and the third party knows or ought to know that the agent is acting as an agent, and the other in which the agent acts on behalf of a principal within the scope of its authority but the third party neither knows nor ought to know that the agent is acting as an agent. The first situation, which is the normal one, may be referred to as “disclosed” agency and is dealt with in this Article.

## **2. Agent's acts directly affect legal relations between principal and third party**

In the case of a “disclosed” agency, the rule is that the agent's acts directly affect the principal's legal position vis-à-vis the third party (paragraph (1)). Thus, a contract made by the agent directly binds the principal and the third party to each other. Likewise, any communication of intention that the agent makes to, or receives from, the third party affects the principal's legal position as if the principal itself had made or received it.

### **Illustrations**

1. A, a sales representative for computer manufacturer B, accepts the order placed by university C for the purchase of a certain number of computers. The sales contract directly binds B vis-à-vis C with the result that it is B, and not A, who is under an obligation to deliver the goods to C and who is entitled to payment by C.
2. The facts are the same as in Illustration 1, except that one of the computers delivered is defective. The notice of such defects given by C to A directly affects B.

## **3. Acting in the principal's name not necessary**

For the establishment of a direct relationship between the principal and the third party it is sufficient that the agent acts within the scope of its authority and that the third party knows or ought to know that the latter acts on behalf of another person. By contrast, it is as a rule not necessary for the agent to act in the principal's name (see also Article 2.2.1(1)).

In practice, however, there might be cases in which it is in the agent's own interest to indicate expressly the identity of the person on whose behalf it is acting. Thus, whenever the contract requires the signature of the parties, the agent is well advised not simply to sign in its own name, but to add language such as “for and on behalf of” followed by the principal's name, so as to avoid any risk of being held personally liable under the contract.

### **Illustrations**

3. The facts are the same as in Illustration 1. For the sales contract to directly bind B vis-à-vis C it is irrelevant whether A, when accepting C's order over the telephone, acts in its own name or expressly states that it is accepting in the name of B.
4. Computer specialist A is contacted by research centre C with a view to creating a computer programme for a special database on

international case law. A, when signing the contract in its capacity as employee of software company B, should expressly state that it is acting on behalf of B. If A merely signs the contract without indicating B, C may hold A personally liable under the contract

#### **4. Agent undertakes to become party to the contract**

An agent, though openly acting on behalf of a principal, may exceptionally itself become party to the contract with the third party (paragraph (2)). This is the case, in particular, where a principal, who wants to remain anonymous, instructs the agent to act as a so-called “commission agent”, i.e. to deal with the third party in its own name without establishing any direct relation between the principal and the third party. This is also the case where the third party makes it clear that it does not intend to contract with anyone other than the agent and the agent, with the consent of the principal, agrees that it alone and not the principal will be bound by the contract. In both cases it will follow from the terms of the agreement between the principal and the agent that, once the agent has acquired its rights under the contract with the third party, it will transfer them to the principal.

Entirely different is the case where the agent steps in and, in violation of its agreement with the principal, decides to become party to the contract with the third party. In so doing the agent no longer acts as an agent, and this case therefore falls outside the scope of this Section.

#### **Illustrations**

5. Dealer B, expecting a substantial increase in the price of wheat, decides to purchase a large quantity of wheat. B, wishing to remain anonymous, entrusts commission agent A with this task. Even though supplier C knows that A is purchasing on behalf of a principal, the purchase contract is binding on A and C and does not directly affect B’s legal position.

6. Confirming house A, acting on behalf of overseas buyer B, places an order with supplier C for the purchase of certain goods. Since C, who does not know B, insists on A’s confirmation of B’s order, A accepts to be held liable itself vis-à-vis C. Even though C knows that A is purchasing on behalf of B, the purchase contract is binding on A and C and does not directly affect B’s legal position.

7. Dealer B instructs agent A to purchase a certain quantity of oil on its behalf. When A is about to conclude the contract with supplier C, the news arrives that the oil producing countries intend to reduce production substantially. A, expecting a rise in oil prices, decides to purchase the oil on its own behalf and enters into the contract with C as the only other party. In so doing A has ceased to act as agent for the principal and the consequences of its acts are no longer governed by this Section.

#### ARTICLE 2.2.4

*(Agency undisclosed)*

**(1) Where an agent acts within the scope of its authority and the third party neither knew nor ought to have known that the agent was acting as an agent, the acts of the agent shall affect only the relations between the agent and the third party.**

**(2) However, where such an agent, when contracting with the third party on behalf of a business, represents itself to be the owner of that business, the third party, upon discovery of the real owner of the business, may exercise also against the latter the rights it has against the agent.**

#### COMMENT

##### 1. “Undisclosed” agency

This Article deals with what may be referred to as “undisclosed” agency, i.e. the situation where an agent acts within the scope of its authority on behalf of a principal but the third party neither knows nor ought to know that the agent is acting as an agent.

##### 2. Agent’s acts directly affect only the relations between agent and third party

Paragraph (1) provides that in the case of an “undisclosed” agency the agent’s acts affect only the relations between the agent and the third party and do not directly bind the principal vis-à-vis the third party.

**Illustration**

1. Art dealer A purchases a painting from artist C. When entering into the contract A does not disclose the fact that it is acting on behalf of client B, nor has C any reason to believe that A is not acting on its own behalf. The contract is binding on A and C only, and does not give rise to a direct relationship between B and C.

**3. Third party's right of action against principal**

Notwithstanding the rule laid down in paragraph (1), the third party may exceptionally have a right of direct action also against the principal. More precisely, according to paragraph (2), if the third party believes that it is dealing with the owner of a business while in fact it is dealing with the owner's agent, it may, upon discovery of the real owner, exercise also against the owner the rights it has against the agent.

**Illustration**

2. Manufacturer A, after having transferred its assets to a newly formed company C, continues to contract in its own name without disclosing to supplier B that it is in fact acting only as the Managing Director of C. Upon discovery of the existence of C, B has a right of action also against that company.

**ARTICLE 2.2.5**

*(Agent acting without or exceeding its authority)*

**(1) Where an agent acts without authority or exceeds its authority, its acts do not affect the legal relations between the principal and the third party.**

**(2) However, where the principal causes the third party reasonably to believe that the agent has authority to act on behalf of the principal and that the agent is acting within the scope of that authority, the principal may not invoke against the third party the lack of authority of the agent.**

## COMMENT

### 1. Lack of authority

Paragraph (1) expressly states that where an agent acts without authority, its acts do not bind the principal and the third party to each other. The same applies to the case where the agent has been granted authority of limited scope and acts exceeding its authority.

As to the liability of the false agent vis-à-vis the third party, see Article 2.2.6.

#### Illustration

1. Principal B authorises agent A to buy on its behalf a specific quantity of grain but without exceeding a certain price. A enters into a contract with seller C for the purchase of a greater quantity of grain and at a higher price than that authorised by B. On account of A's lack of authority, the contract between A and C does not bind B, nor does it become effective between A and C.

### 2. Apparent authority

There are two cases in which an agent, though acting without authority or exceeding its authority, may bind the principal and the third party to each other.

The first case occurs whenever the principal ratifies the agent's act and is dealt with in Article 2.2.9.

The second case is that of so-called "apparent authority" and is dealt with in paragraph (2) of this Article. According to this provision a principal, whose conduct leads a third party reasonably to believe that the agent has authority to act on its behalf, is prevented from invoking against the third party the lack of authority of the agent and is therefore bound by the latter's act.

Apparent authority, which is an application of the general principle of good faith (see Article 1.7) and of the prohibition of inconsistent behaviour (see Article 1.8), is especially important if the principal is not an individual but an organisation. In dealing with a corporation, partnership or other business association a third party may find it difficult to determine whether the persons acting for the organisation have actual authority to do so and may therefore prefer, whenever possible, to rely on their apparent authority. For this purpose the third party only has to demonstrate that it was reasonable for it to believe that the person purporting to represent the organisation was authorised

to do so, and that this belief was caused by the conduct of those actually authorised to represent the organisation (Board of Directors, executive officers, partners, etc.). Whether or not the third party's belief was reasonable will depend on the circumstances of the case (position occupied by the apparent agent in the organisation's hierarchy, type of transaction involved, acquiescence of the organisation's representatives in the past, etc.).

### Illustrations

2. A, a manager of one of company B's branch offices, though lacking actual authority to do so, engages construction company C to redecorate the branch's premises. In view of the fact that a branch manager normally would have authority to enter into such a contract, B is bound by the contract with C since it was reasonable for C to believe that A had actual authority to enter into the contract.

3. A, Chief Financial Officer of company B, though lacking authority to do so, has, with the acquiescence of the Board of Directors, repeatedly entered into financial transactions with bank C on behalf of B. On the occasion of a new transaction which proves to be disadvantageous to B, B's Board of Directors raises against C the objection of A's lack of authority. C may defeat this objection by claiming that B is bound by A's apparent authority to enter into the financial transaction on B's behalf.

### ARTICLE 2.2.6

*(Liability of agent acting without or exceeding its authority)*

**(1) An agent that acts without authority or exceeds its authority is, failing ratification by the principal, liable for damages that will place the third party in the same position as if the agent had acted with authority and not exceeded its authority.**

**(2) However, the agent is not liable if the third party knew or ought to have known that the agent had no authority or was exceeding its authority.**



## COMMENT

### 1. Liability of false agent

It is generally recognised that an agent acting without authority or exceeding its authority shall, failing ratification by the principal, be liable for damages to the third party. Paragraph (1), in stating that the false agent shall be liable to pay the third party such compensation as will place the third party in the same position as it would have been in if the agent had acted with authority, makes it clear that the liability of the false agent is not limited to the so-called reliance or negative interest, but extends to the so-called expectation or positive interest. In other words, the third party may recover the profit that would have resulted if the contract concluded with the false agent had been a valid one.

#### Illustration

1. Agent A, without being authorised by principal B, enters into a contract with third party C for the sale of a cargo of oil belonging to B. Failing B's ratification of the contract, C may recover from A the difference between the contract price and the current market price.

### 2. Third party's knowledge of agent's lack of authority

The false agent is liable to the third party only to the extent that the third party, when entering into the contract with the false agent, neither knew nor ought to have known that the latter was acting without authority or exceeding its authority.

#### Illustration

2. A, a junior employee of company B, without having authority to do so engages construction company C to redecorate B's premises. B refuses to ratify the contract. Nevertheless C may not request damages from A since it should have known that an employee of A's rank normally has no authority to enter into such a contract.

**ARTICLE 2.2.7**  
*(Conflict of interests)*

**(1) If a contract concluded by an agent involves the agent in a conflict of interests with the principal of which the third party knew or ought to have known, the principal may avoid the contract. The right to avoid is subject to Articles 3.2.9 and 3.2.11 to 3.2.15.**

**(2) However, the principal may not avoid the contract**

**(a) if the principal had consented to, or knew or ought to have known of, the agent's involvement in the conflict of interests; or**

**(b) if the agent had disclosed the conflict of interests to the principal and the latter had not objected within a reasonable time.**

**COMMENT**

**1. Conflict of interests between agent and principal**

It is inherent in any agency relationship that the agent, in fulfilling its mandate, will act in the interest of the principal and not in its own interest or in that of anyone else if there is a conflict between such an interest and that of the principal.

The most frequent cases of potential conflict of interests are those where the agent acts for two principals and those where the agent concludes the contract with itself or with a firm in which it has an interest. However, in practice even in such cases a real conflict of interests may not exist. Thus, for instance, the agent's acting for two principals may be in conformity with the usages of the trade sector concerned, or the principal may have conferred on the agent a mandate which is so stringent as to leave it no margin for manoeuvre.

**2. Conflict of interests as grounds for avoidance of the contract**

Paragraph (1) of this Article lays down the rule that a contract concluded by an agent acting in a situation of real conflict of interests may be avoided by the principal, provided that the third party knew or ought to have known of the conflict of interests.

The requirement of the actual or constructive knowledge of the third party is intended to protect the innocent third party's interest in

preserving the contract. This requirement is obviously no longer relevant where the agent concludes the contract with itself and is therefore at one and the same time agent and third party.

### Illustrations

1. Solicitor A is requested by foreign client B to purchase on its behalf an apartment in A's city. A buys an apartment client C has requested A to sell on its behalf. B may avoid the contract if it can prove that C knew or ought to have known of A's conflict of interests. Likewise, C may avoid the contract if it can prove that B knew or ought to have known of A's conflict of interests.
2. Sales agent A, requested by retailer B to purchase certain goods on its behalf, purchases the goods from company C in which A is a majority shareholder. B may avoid the contract if it can prove that C knew or ought to have known of A's conflict of interests.
3. Client B instructs bank A to buy on its behalf one thousand shares of company C at the closing price of day M on the stock exchange of city Y. Even if A sells B the requested shares from out of those it has in its own portfolio, there can be no conflict of interests because B's mandate leaves A no margin for manoeuvre.
4. A, Chief Executive Officer of company B, has authority to appoint the company's counsel in the event of a law suit being brought by or against B. A appoints itself as B's counsel. B may avoid the contract.

### 3. Procedure for avoidance

As to the procedure for avoidance, the provisions laid down in Articles 3.2.9 (*Confirmation*), 3.2.11 (*Notice of avoidance*), 3.2.12 (*Time limits*), 3.2.13 (*Partial avoidance*), 3.2.14 (*Retroactive effect of avoidance*) and 3.2.15 (*Restitution*) apply.

### 4. Avoidance excluded

According to paragraph (2), the principal loses its right to avoid the contract if it has given its prior consent to the agent's acting in a situation of conflict of interests, or at any rate knew or ought to have known that the agent would do so. The right of avoidance is likewise excluded if the principal, having been informed by the agent of the contract it has concluded in a situation of conflict of interests, raises no objection.

### Illustration

5. The facts are the same as in Illustration 1, except that before concluding the contract A duly informs B that it is acting as agent also for C. If B does not object B loses its right to avoid the contract. Likewise, if A duly informs C that it is acting as agent also for B and C does not object, C loses its right to avoid the contract.

## 5. Issues not covered by this Article

In conformity with the scope of this Section set out in Article 2.2.1, this Article addresses only the impact that the agent's involvement in a conflict of interests situation may have on the external relationship. Issues such as the agent's duty of full disclosure vis-à-vis the principal and the principal's right to damages from the agent may be settled on the basis of other provisions of the Principles (see Articles 1.7, 3.2.16, 7.4.1 *et seq.*) or are otherwise governed by the law applicable to the internal relationship between principal and agent.

### ARTICLE 2.2.8

*(Sub-agency)*

**An agent has implied authority to appoint a sub-agent to perform acts which it is not reasonable to expect the agent to perform itself. The rules of this Section apply to the sub-agency.**

### COMMENT

#### 1. Role of sub-agents

In carrying out the mandate conferred on it by the principal, an agent may find it convenient or even necessary to avail itself of the services of other persons. This is the case, for instance, where certain tasks are to be performed in a place distant from the agent's place of business, or if a more efficient performance of the agent's mandate requires distribution of work.

#### 2. Implied authority to appoint sub-agents

Whether or not the agent is authorised to appoint one or more sub-agents depends on the terms of the authority granted by the principal.

Thus, the principal may expressly exclude the appointment of sub-agents or make it conditional upon its prior approval. If nothing is said in the authorisation as to the possibility of appointing sub-agents and the terms of the authority granted are not otherwise inconsistent with such a possibility, the agent has the right under this Article to appoint sub-agents. The only limitation is that the agent may not entrust the sub-agent(s) with tasks that it is reasonable to expect the agent itself to perform. This is the case in particular of acts requiring the agent's personal expertise.

### Illustrations

1. Chinese museum B instructs a London-based art dealer A to buy a particular piece of Greek pottery on sale at a private auction in Germany. A has implied authority to appoint German sub-agent S to purchase that piece of pottery at the auction in Germany and to send it to B.
2. The facts are the same as in Illustration 1, except that B does not specify the particular piece of Greek pottery to be acquired at the auction in Germany as it relies on A's expertise to choose the most suitable item offered for sale. A is expected to make the purchase at the auction itself, but once it has purchased the piece of pottery, it may appoint sub-agent S to send it to B.

### 3. Effects of a sub-agent's acts

This Article expressly states that the rules of this Section apply to the sub-agency. In other words, the acts of a sub-agent legitimately appointed by the agent bind the principal and the third party to each other, provided that those acts are within both the agent's authority and the authority conferred on the sub-agent by the agent, which may be more limited.

### Illustration

3. The facts are the same as in Illustration 1. The purchase of the piece of Greek pottery by S directly binds B provided that it is within both the authority that B has granted to A and the authority that A has granted to S.

**ARTICLE 2.2.9***(Ratification)*

**(1) An act by an agent that acts without authority or exceeds its authority may be ratified by the principal. On ratification the act produces the same effects as if it had initially been carried out with authority.**

**(2) The third party may by notice to the principal specify a reasonable period of time for ratification. If the principal does not ratify within that period of time it can no longer do so.**

**(3) If, at the time of the agent's act, the third party neither knew nor ought to have known of the lack of authority, it may, at any time before ratification, by notice to the principal indicate its refusal to become bound by a ratification.**

**COMMENT****1. Notion of ratification**

This Article lays down the generally accepted principle whereby acts which have no effect on the principal because they have been carried out by an agent holding itself out to have authority but actually without authority or exceeding its authority, may be authorised by the principal at a later stage. Such subsequent authorisation is known as “ratification”.

Like the original authorisation, ratification is not subject to any requirement as to form. As it is a unilateral manifestation of intent, it may be either express or implied from words or conduct and, though normally communicated to the agent, to the third party, or to both, it need not be communicated to anyone, provided that it is manifested in some way and can therefore be ascertained by probative material.

**Illustration**

Agent A purchases on behalf of principal B goods from third party C at a price higher than that which A is authorised to pay. Upon receipt of C's bill, B makes no objection and pays it by bank transfer. The payment amounts to ratification of A's act even if B does not expressly declare its intention to ratify, fails to inform

both A and C of the payment and C is only subsequently informed of the payment by its bank.

## **2. Effects of ratification**

On ratification the agent's acts produce the same effects as if they had been carried out with authority from the outset (paragraph (1)). It follows that the third party may refuse partial ratification of the agent's acts by the principal as it would amount to a proposal by the principal to modify the contract that the third party has concluded with the agent. In turn, the principal may not revoke ratification after it has been brought to the attention of the third party. Otherwise the principal would be in a position to withdraw unilaterally from the contract with the third party.

## **3. Time of ratification**

The principal may in principle ratify at any time. The reason for this is that normally the third party does not even know that it has contracted with an agent who did not have authority or who exceeded its authority. However, even if the third party knows from the outset, or subsequently becomes aware, that the agent was a false agent, it will have a legitimate interest not to be left in doubt indefinitely as to the ultimate fate of the contract concluded with the false agent. Accordingly, paragraph (2) grants the third party the right to set a reasonable time limit within which the principal must ratify if it intends to do so. It goes without saying that in such a case ratification must be notified to the third party.

## **4. Ratification excluded by third party**

A third party, who when dealing with the agent neither knew nor ought to have known of that agent's lack of authority, may exclude ratification by giving the principal notice to this effect any time before ratification by the latter. The reason for granting the innocent third party such a right is to avoid that the principal is the only one in a position to speculate and to decide whether or not to ratify depending on market developments.

## **5. Third persons' rights not affected**

This Article deals only with the effects of ratification on the three parties directly involved in the agency relationship, i.e. the principal, the agent and the third party. In accordance with the scope of this Section as defined in Article 2.2.1, the rights of other third persons are

not affected. For instance, if the same goods have been sold first by the false agent to C, and subsequently by the principal to another person D, the conflict between C and D as a result of the principal's subsequent ratification of the first sale will have to be solved by the applicable law.

**ARTICLE 2.2.10**  
*(Termination of authority)*

**(1) Termination of authority is not effective in relation to the third party unless the third party knew or ought to have known of it.**

**(2) Notwithstanding the termination of its authority, an agent remains authorised to perform the acts that are necessary to prevent harm to the principal's interests.**

**COMMENT**

**1. Grounds for termination not covered by this Article**

There are several grounds on which the agent's authority may be terminated: revocation by the principal, renunciation by the agent, completion of the act(s) for which authority had been granted, loss of capacity, bankruptcy, death or cessation of the existence of the principal or the agent, etc. What exactly constitutes a ground for termination and the way it operates as between the principal and the agent falls outside the scope of this Article and is to be determined in accordance with the applicable laws (e.g. the law governing the internal relations between principal and agent, the law governing their legal status or personality, the law governing bankruptcy, etc.) which may vary considerably from one country to another.

**2. Termination effective vis-à-vis third party**

Whatever the grounds for termination of the agent's authority, in relation to the third party termination is not effective unless the third party knew or ought to have known of it (paragraph (1)). In other words, even if the agent's authority has been terminated for one reason or another, the agent's acts continue to affect the legal relationship between the principal and the third party as long as the third party is



neither aware of nor ought to know that the agent no longer has authority.

Obviously the situation is clear whenever either the principal or the agent gives the third party notice of the termination. In the absence of such notice it will depend on the circumstances of the case whether the third party ought to have known of the termination.

### Illustrations

1. Principal B opens a branch office in city X. An advertisement published in the local newspaper indicates Managing Director A as having full authority to act on behalf of B. When B subsequently revokes A's authority, a similar notice thereof in the same newspaper is sufficient to make the termination effective vis-à-vis B's customers in city X.
2. Retailer C has repeatedly placed orders with sales representative A for the purchase of goods sold by principal B. A continues to accept orders from C even after its authority has been terminated on account of B's bankruptcy. The mere fact that the bankruptcy proceedings were given the publicity required by the applicable law is not sufficient to make the termination effective vis-à-vis C.

### 3. Authority of necessity

Even after termination of the agent's authority the circumstances of the case may make it necessary for the agent to perform additional acts in order to prevent the principal's interests from being harmed.

#### Illustration

3. Agent A has authority to purchase a certain quantity of perishable goods on behalf of principal B. After the purchase of the goods A is informed of B's death. Notwithstanding the termination of its authority, A continues to be authorised either to resell the goods or to store them in a suitable warehouse.

### 4. Restriction of authority also covered

The rules of this Article apply not only to termination but, with appropriate modifications, also to subsequent restrictions of an agent's authority.

## CHAPTER 3

### VALIDITY

#### SECTION 1: GENERAL PROVISIONS

##### ARTICLE 3.1.1

*(Matters not covered)*

**This Chapter does not deal with lack of capacity.**

##### COMMENT

This Article makes it clear that not all the grounds of invalidity of a contract to be found in the various national legal systems fall within the scope of the Principles. This is in particular the case of lack of capacity. The reason for its exclusion lies in both the inherent complexity of questions of status and the extremely diverse manner in which these questions are treated in domestic law. In consequence, matters such as *ultra vires* will continue to be governed by the applicable law.

As to the authority of organs, officers or partners of a corporation, partnership or other entities to bind their respective entities, see Comment 5 on Article 2.2.1.

##### ARTICLE 3.1.2

*(Validity of mere agreement)*

**A contract is concluded, modified or terminated by the mere agreement of the parties, without any further requirement.**

**COMMENT**

The purpose of this Article is to make it clear that the mere agreement of the parties is sufficient for the valid conclusion, modification or termination by agreement of a contract, without any of the further requirements which are to be found in some domestic laws.

**1. No need for consideration**

In common law systems, “consideration” is traditionally seen as a prerequisite for the validity or enforceability of a contract, as well as for the modification or termination of a contract by the parties.

However, in commercial dealings this requirement is of minimal practical importance since in that context obligations are almost always undertaken by both parties. It is for this reason that Article 29(1) CISG dispenses with the requirement of consideration in relation to the modification and termination by the parties of contracts for the international sale of goods. The fact that this Article extends this approach to the conclusion, modification and termination by the parties of international commercial contracts in general can only bring about greater certainty and reduce litigation.

**2. No need for *cause***

This Article also excludes the requirement of “*cause*” which exists in some civil law systems and is in certain respects functionally similar to the common law “consideration”.

**Illustration**

1. At the request of its French customer A, bank B in Paris issues a guarantee on first demand in favour of C, a business partner of A in England. Neither B nor A can invoke the possible absence of consideration or *cause* for the guarantee.

It should be noted, however, that this Article is not concerned with the effects which may derive from other aspects of *cause*, such as its illegality (see Comment 2 on Article 3.1.3).

**3. All contracts consensual**

Some civil law systems have retained certain types of “real” contract, i.e. contracts concluded only upon the actual handing over of the goods concerned. These rules are not easily compatible with modern business perceptions and practice and are therefore excluded by this Article.

## Illustration

2. Two French businessmen, A and B, agree with C, a real estate developer, to lend C EUR 300,000 on 2 July. On 25 June, A and B inform C that, unexpectedly, they need the money for their own business. C is entitled to receive the loan, although the loan is generally considered a “real” contract in France.

## ARTICLE 3.1.3

*(Initial impossibility)*

**(1) The mere fact that at the time of the conclusion of the contract the performance of the obligation assumed was impossible does not affect the validity of the contract.**

**(2) The mere fact that at the time of the conclusion of the contract a party was not entitled to dispose of the assets to which the contract relates does not affect the validity of the contract.**

## COMMENT

**1. Performance impossible from the outset**

Contrary to a number of legal systems which consider a contract of sale void if the specific goods sold have already perished at the time of conclusion of the contract, paragraph (1) of this Article, in conformity with the most modern trends, states in general terms that the mere fact that at the time of the conclusion of the contract the performance of the obligation assumed was impossible does not affect the validity of the contract.

A contract is valid even if the assets to which it relates have already perished at the time of contracting, with the consequence that initial impossibility of performance is equated with impossibility occurring after the conclusion of the contract. The rights and duties of the parties arising from one party's (or possibly even both parties') inability to perform are to be determined according to the rules on non-performance. Under these rules appropriate weight may be attached, for example, to the fact that the obligor (or the obligee) already knew of the impossibility of performance at the time of contracting. The rule laid down in paragraph (1) also removes possible doubts as to the validity of contracts for the delivery of future goods.

If an initial impossibility of performance is due to a legal prohibition (e.g. an export or import embargo), the validity of the contract depends upon whether under the law enacting the prohibition the latter is intended to invalidate the contract or merely to prohibit its performance.

Paragraph (1) moreover departs from the rule to be found in some civil law systems according to which the object (*objet*) of a contract must be possible.

The paragraph also deviates from the rule of the same systems which requires the existence of a *cause*, since, in a case of initial impossibility, the *cause* for a counter-performance is lacking (see Article 3.1.2).

## **2. Lack of legal title or power**

Paragraph (2) of this Article deals with cases where the party promising to transfer or deliver assets was not entitled to dispose of the assets because it lacked legal title or the right of disposition at the time of the conclusion of the contract.

Some legal systems declare a contract of sale concluded in such circumstances to be void. Yet, as in the case with initial impossibility, and for even more cogent reasons, paragraph (2) of this Article considers such a contract to be valid. Indeed, a contracting party may, and often does, acquire legal title to, or the power of disposition over, the assets in question after the conclusion of the contract. Should this not occur, the rules on non-performance will apply.

Cases where the power of disposition is lacking must be distinguished from those of lack of capacity. The latter relate to certain disabilities of a person which may affect all or at least some types of contract concluded by it, and falls outside the scope of the Principles (see Article 3.1.1).

**ARTICLE 3.1.4**

*(Mandatory character of the provisions)*

**The provisions on fraud, threat, gross disparity and illegality contained in this Chapter are mandatory.**

**COMMENT**

The provisions of this Chapter relating to fraud, threat, gross disparity and illegality are of a mandatory character. It would be contrary to good faith for the parties to exclude or modify these provisions when concluding their contract. However, nothing prevents the party entitled to avoidance for fraud, threat and gross disparity to waive that right once that party learns of the true facts or is able to act freely.

On the other hand, the provisions of this Chapter relating to the binding force of a mere agreement, to initial impossibility or to mistake are not mandatory. Thus the parties may reintroduce special requirements of domestic law, such as consideration or *cause*. They may likewise agree that their contract shall be invalid in case of initial impossibility, or that mistake by one of the parties is not a ground for avoidance.

## SECTION 2: GROUNDS FOR AVOIDANCE

### ARTICLE 3.2.1

*(Definition of mistake)*

**Mistake is an erroneous assumption relating to facts or to law existing when the contract was concluded.**

#### COMMENT

##### 1. Mistake of fact and mistake of law

This Article equates a mistake relating to facts with a mistake relating to law. Identical legal treatment of the two types of mistake seems justified in view of the increasing complexity of modern legal systems. For cross-border trade the difficulties caused by this complexity are exacerbated by the fact that an individual transaction may be affected by foreign and therefore unfamiliar legal systems.

##### 2. Decisive time

This Article indicates that a mistake must involve an erroneous assumption relating to the factual or legal circumstances that exist at the time of the conclusion of the contract.

The purpose of fixing this time element is to distinguish cases where the rules on mistake with their particular remedies apply from those relating to non-performance. Indeed, a typical case of mistake may, depending on the point of view taken, often just as well be seen as one involving an obstacle which prevents or impedes the performance of the contract. If a party has entered into a contract under a misconception as to the factual or legal context and therefore misjudged its prospects under that contract, the rules on mistake will apply. If, on the other hand, a party has a correct understanding of the surrounding circumstances but makes an error of judgment as to its prospects under the contract, and later refuses to perform, then the case is one of non-performance rather than mistake.

**ARTICLE 3.2.2**  
*(Relevant mistake)*

**(1) A party may only avoid the contract for mistake if, when the contract was concluded, the mistake was of such importance that a reasonable person in the same situation as the party in error would only have concluded the contract on materially different terms or would not have concluded it at all if the true state of affairs had been known, and**

**(a) the other party made the same mistake, or caused the mistake, or knew or ought to have known of the mistake and it was contrary to reasonable commercial standards of fair dealing to leave the mistaken party in error; or**

**(b) the other party had not at the time of avoidance reasonably acted in reliance on the contract.**

**(2) However, a party may not avoid the contract if**

**(a) it was grossly negligent in committing the mistake; or**

**(b) the mistake relates to a matter in regard to which the risk of mistake was assumed or, having regard to the circumstances, should be borne by the mistaken party.**

**COMMENT**

This Article states the conditions necessary for a mistake to be relevant with a view to avoidance of the contract. The introductory part of paragraph (1) determines the conditions under which a mistake is sufficiently serious to be taken into account; sub-paragraphs (a) and (b) of paragraph (1) add the conditions regarding the party other than the mistaken party; paragraph (2) deals with the conditions regarding the mistaken party.

**1. Serious mistake**

To be relevant, a mistake must be serious. Its weight and importance are to be assessed by reference to a combined objective/subjective standard, namely what “a reasonable person in the same situation as



the party in error” would have done if it had known the true circumstances at the time of the conclusion of the contract. If it would not have contracted at all, or would have done so only on materially different terms, then, and only then, is the mistake considered to be serious.

In this context the introductory part of paragraph (1) relies on an open-ended formula, rather than indicating specific essential elements of the contract to which the mistake must relate. This flexible approach allows full account to be taken of the intentions of the parties and the circumstances of the case. In ascertaining the parties’ intentions, the rules of interpretation laid down in Chapter 4 must be applied. General commercial standards and relevant usages will be particularly important.

Normally in commercial transactions certain mistakes, such as those concerning the value of goods or services or mere expectations or motivations of the mistaken party, are not considered to be relevant. The same is true of mistakes as to the identity of the other party or its personal qualities, although special circumstances may sometimes render such mistakes relevant (e.g. when services to be rendered require certain personal qualifications or when a loan is based upon the credit-worthiness of the borrower).

The fact that a reasonable person would consider the circumstances erroneously assumed to be essential is however not sufficient, since additional requirements concerning both the mistaken and the other party must be met if a mistake is to become relevant.

## **2. Conditions concerning the party other than the mistaken party**

A mistaken party may avoid the contract only if the other party satisfies one of four conditions laid down in paragraph (1).

The first three conditions indicated in sub-paragraph (a) have in common the fact that the other party does not deserve protection because of its involvement in one way or another with the mistaken party’s error.

The first condition is that both parties laboured under the same mistake.

### **Illustration**

1. A and B, when concluding a contract for the sale of a sports car, were not and could not have been aware of the fact that the car had in the meantime been stolen. Avoidance of the contract is admissible.

However, if the parties erroneously believe the object of the contract to be in existence at the time of the conclusion of the contract, while in

reality it had already been destroyed, Article 3.1.3 has to be taken into account.

The second condition is that the error of the mistaken party is caused by the other party. This is the case whenever the error can be traced to specific representations made by the latter party, be they express or implied, negligent or innocent, or to conduct which in the circumstances amounts to a representation. Even silence may cause an error. A mere “puff” in advertising or in negotiations will normally be tolerated.

If the error was caused intentionally, Article 3.2.5 applies.

The third condition is that the other party knew or ought to have known of the error of the mistaken party and that it was contrary to reasonable commercial standards of fair dealing to leave the mistaken party in error. What the other party ought to have known is what should have been known to a reasonable person in the same situation as that party. In order to avoid the contract the mistaken party must also show that the other party was under a duty to inform it of its error.

The fourth condition is laid down in sub-paragraph (b) and is that the party other than the mistaken party had not, up to the time of avoidance, reasonably acted in reliance on the contract. For the time of avoidance, see Articles 3.2.12 and 1.10.

### **3. Conditions concerning the mistaken party**

Paragraph (2) of this Article mentions two cases in which the mistaken party may not avoid the contract.

The first of these, dealt with in sub-paragraph (a), is that the error is due to the gross negligence of the mistaken party. In such a situation it would be unfair to the other party to allow the mistaken party to avoid the contract.

Sub-paragraph (b) contemplates the situation where the mistaken party either has assumed the risk of mistake or where this risk should in the circumstances be borne by it. An assumption of the risk of mistake is a frequent feature of speculative contracts. A party may conclude a contract in the hope that its assumption of the existence of certain facts will prove to be correct, but may nevertheless undertake to assume the risk of this not being so. In such circumstances it will not be entitled to avoid the contract for its mistake.

### Illustration

2. A sells to B a picture “attributed” to the relatively unknown painter C at a fair price for such paintings. It is subsequently discovered that the work was painted by the famous artist D. A cannot avoid its contract with B on the ground of its mistake, since the fact that the picture was only “attributed” to C implied the risk that it might have been painted by a more famous artist.

Sometimes both parties assume a risk. However, speculative contracts involving conflicting expectations of future developments, e.g. those concerning prices and exchange rates, may not be avoided on the ground of mistake, since the mistake would not be one as to facts existing at the time of the conclusion of the contract.

### ARTICLE 3.2.3

*(Error in expression or transmission)*

**An error occurring in the expression or transmission of a declaration is considered to be a mistake of the person from whom the declaration emanated.**

### COMMENT

This Article equates an error in the expression or transmission of a declaration with an ordinary mistake of the person making the declaration or sending it and thus the rules of Article 3.1.4, Article 3.2.2 and Articles 3.2.9 to 3.2.16 apply also to these kinds of error.

#### 1. Relevant mistake

If an error in expression or transmission is of sufficient magnitude (especially if it has resulted in the misstatement of figures), the receiver will be, or ought to be, aware of the error. Since nothing in the Principles prevents the receiver/offeree from accepting the erroneously expressed or transmitted offer, it is for the sender/offeror to invoke the error and to avoid the contract provided that the conditions of Article 3.2.2 are met, in particular that it was contrary to reasonable commercial standards of fair dealing for the receiver/offeree not to inform the sender/offeror of the error.

In some cases the risk of the error may have been assumed by, or may have to be imposed upon, the sender if it uses a method of transmission which it knows or ought to know to be unsafe either in general or in the special circumstances of the case.

## **2. Mistakes on the part of the receiver**

Transmission ends as soon as the message reaches the receiver (see Article 1.10).

If the message is correctly transmitted, but the receiver misunderstands its content, the case falls outside the scope of this Article.

If the message is correctly transmitted to the receiver's machine which, however, due to a technical fault, prints out a mutilated text, the case is again outside the scope of this Article. The same is true if, at the receiver's request, a message is given orally to the receiver's messenger who misunderstands it or transmits it wrongly.

In the two above-mentioned situations the receiver may however be entitled to invoke its own mistake in accordance with Article 3.2.2, if it replies to the sender and bases its reply upon its own misunderstanding of the sender's message and if all the conditions of Article 3.2.2 are met.

### **ARTICLE 3.2.4**

*(Remedies for non-performance)*

**A party is not entitled to avoid the contract on the ground of mistake if the circumstances on which that party relies afford, or could have afforded, a remedy for non-performance.**

#### **COMMENT**

### **1. Remedies for non-performance preferred**

This Article is intended to resolve the conflict which may arise between the remedy of avoidance for mistake and the remedies for non-performance. In the event of such a conflict, preference is given to the remedies for non-performance since they seem to be better suited and are more flexible than the radical solution of avoidance.

## 2. Actual and potential conflicts

An actual conflict between the remedies for mistake and those for non-performance arises whenever the two sets of remedies are invoked in relation to what are essentially the same facts.

### Illustration

A, a farmer, who finds a rusty cup on the land sells it to B, an art dealer, for EUR 10,000. The high price is based upon the assumption of both parties that the cup is made of silver (other silver objects had previously been found on the land). It subsequently turns out that the object in question is an ordinary iron cup worth only EUR 1,000. B refuses to accept the cup and to pay for it on the ground that it lacks the assumed quality. B also avoids the contract on the ground of mistake as to the quality of the cup. B is entitled only to the remedies for non-performance.

It may be that the conflict between the two sets of remedies is only potential, since the mistaken party could have relied upon a remedy for non-performance, but is actually precluded from doing so by special circumstances, for example because a statutory limitation period has lapsed. Even in such a case this Article applies with the consequence that the remedy of avoidance for mistake is excluded.

## ARTICLE 3.2.5

*(Fraud)*

**A party may avoid the contract when it has been led to conclude the contract by the other party's fraudulent representation, including language or practices, or fraudulent non-disclosure of circumstances which, according to reasonable commercial standards of fair dealing, the latter party should have disclosed.**

### COMMENT

#### 1. Fraud and mistake

Avoidance of a contract by a party on the ground of fraud bears some resemblance to avoidance for a certain type of mistake. Fraud may be regarded as a special case of mistake caused by the other

party. Fraud, like mistake, may involve either representations, whether express or implied, of false facts or non-disclosure of true facts.

## **2. Notion of fraud**

The decisive distinction between fraud and mistake lies in the nature and purpose of the defrauding party's representations or non-disclosure. What entitles the defrauded party to avoid the contract is the "fraudulent" representation or non-disclosure of relevant facts. Such conduct is fraudulent if it is intended to lead the other party into error and thereby to gain an advantage to the detriment of the other party. The reprehensible nature of fraud is such that it is a sufficient ground for avoidance without the need for the presence of the additional conditions laid down in Article 3.2.2 for the mistake to become relevant.

A mere "puff" in advertising or negotiations does not suffice.

### **ARTICLE 3.2.6**

#### *(Threat)*

**A party may avoid the contract when it has been led to conclude the contract by the other party's unjustified threat which, having regard to the circumstances, is so imminent and serious as to leave the first party no reasonable alternative. In particular, a threat is unjustified if the act or omission with which a party has been threatened is wrongful in itself, or it is wrongful to use it as a means to obtain the conclusion of the contract.**

#### **COMMENT**

This Article permits the avoidance of a contract on the ground of threat.

#### **1. Threat must be imminent and serious**

Threat of itself is not sufficient. It must be of so imminent and serious a character that the threatened person has no reasonable alternative but to conclude the contract on the terms proposed by the

other party. The imminence and seriousness of the threat must be evaluated by an objective standard, taking into account the circumstances of the individual case.

## **2. Unjustified threat**

The threat must in addition be unjustified. The second sentence of this Article sets out, by way of illustration, two examples of an unjustified threat. The first envisages a case where the act or omission with which the contracting party has been threatened is wrongful in itself (e.g. a physical attack). The second refers to a situation where the threatened act or omission is in itself lawful, but the purpose to be achieved is wrongful (e.g. the bringing of a court action for the sole purpose of inducing the other party to conclude the contract on the terms proposed).

### **Illustration**

1. A, who is in default with the repayment of a loan, is threatened by B, the lender, with proceedings for the recovery of the money. The only purpose of this threat is to obtain on particularly advantageous terms a lease of A's warehouse. A signs the lease, but is entitled to avoid the contract.

## **3. Threat affecting reputation or economic interests**

For the purpose of the application of this Article, threat need not necessarily be made against a person or property, but may also affect reputation or purely economic interests.

### **Illustration**

2. Faced with a threat by the players of a basketball team to go on strike unless they receive a much higher bonus than had already been agreed for winning the four remaining matches of the season, the owner of the team agrees to pay the requested bonus. The owner is entitled to avoid the new contract with the players, since the strike would have led automatically to the team being relegated to a minor league and therefore represented a serious and imminent threat to both the reputation and the financial position of the club.

**ARTICLE 3.2.7**  
*(Gross disparity)*

**(1) A party may avoid the contract or an individual term of it if, at the time of the conclusion of the contract, the contract or term unjustifiably gave the other party an excessive advantage. Regard is to be had, among other factors, to**

**(a) the fact that the other party has taken unfair advantage of the first party's dependence, economic distress or urgent needs, or of its improvidence, ignorance, inexperience or lack of bargaining skill, and**

**(b) the nature and purpose of the contract.**

**(2) Upon the request of the party entitled to avoidance, a court may adapt the contract or term in order to make it accord with reasonable commercial standards of fair dealing.**

**(3) A court may also adapt the contract or term upon the request of the party receiving notice of avoidance, provided that that party informs the other party of its request promptly after receiving such notice and before the other party has reasonably acted in reliance on it. Article 3.2.10(2) applies accordingly.**

**COMMENT**

**1. Excessive advantage**

This provision permits a party to avoid a contract in cases where there is gross disparity between the obligations of the parties, which gives one party an unjustifiably excessive advantage.

The excessive advantage must exist at the time of the conclusion of the contract. A contract which, although not grossly unfair when entered into, becomes so later may be adapted or terminated under the rules on hardship contained in Chapter 6, Section 2.

As the term "excessive" advantage denotes, even a considerable disparity in the value and the price or some other element which upsets the equilibrium of performance and counter-performance is not



sufficient to permit the avoidance or the adaptation of the contract under this Article. What is required is that the disequilibrium is in the circumstances so great as to shock the conscience of a reasonable person.

## 2. Unjustifiable advantage

Not only must the advantage be excessive, it must also be unjustifiable. Whether this requirement is met will depend upon an evaluation of all the relevant circumstances of the case. Paragraph (1) of this Article refers in particular to two factors which deserve special attention in this connection.

### a. *Unequal bargaining position*

The first factor is that one party has taken unfair advantage of the other party's dependence, economic distress or urgent needs, or its improvidence, ignorance, inexperience, or lack of bargaining skill (sub-paragraph (a)). As to the dependence of one party vis-à-vis the other, superior bargaining power due to market conditions alone is not sufficient.

### Illustration

A, the owner of an automobile factory, sells an outdated assembly line to B, a Governmental agency from a country eager to set up its own automobile industry. Although A makes no representations as to the efficiency of the assembly line, it succeeds in fixing a price which is manifestly excessive. B, after discovering that it has paid an amount which corresponds to that of a much more modern assembly line, is entitled to avoid the contract.

### b. *Nature and purpose of the contract*

The second factor to which special regard must be had is the nature and purpose of the contract (sub-paragraph (b)). There are situations where an excessive advantage is unjustifiable even if the party who will benefit from it has not abused the other party's weak bargaining position.

Whether this is the case will often depend upon the nature and purpose of the contract. Thus, a contract term providing for an extremely short period for giving notice of defects in goods or services to be supplied may or may not be excessively advantageous to the seller or supplier, depending on the character of the goods or services in question.

Equally, an agent's fee expressed in terms of a fixed percentage of the price of the goods or services to be sold or rendered, although justified in the event of the agent's contribution to the conclusion of the transaction being substantial and/or the value of the goods or services concerned not being very high, may well turn out to confer an excessive advantage on the agent if the latter's contribution is almost negligible and/or the value of the goods or services are extraordinarily high.

*c. Other factors*

Other factors may need to be taken into consideration, for example the ethics prevailing in the business or trade.

### **3. Avoidance or adaptation**

The avoidance of the contract or of any of its individual terms under this Article is subject to the general rules laid down in Articles 3.2.11 to 3.2.16.

However, according to paragraph (2) of this Article, at the request of the party who is entitled to avoidance, the court may adapt the contract in order to bring it into accord with reasonable commercial standards of fair dealing. Similarly, according to paragraph (3) the party receiving notice of avoidance may also request such adaptation provided it informs the avoiding party of its request promptly after receiving the notice of avoidance, and before the avoiding party has reasonably acted in reliance on that notice.

After such a request by the other party, the party entitled to avoidance loses its right to avoid the contract and any earlier notice of avoidance becomes ineffective (see Article 3.2.10(2)).

If the parties are in disagreement as to the procedure to be adopted, it will be for the court to decide whether the contract is to be avoided or adapted and, if adapted, on which terms.

#### **ARTICLE 3.2.8**

*(Third persons)*

**(1) Where fraud, threat, gross disparity or a party's mistake is imputable to, or is known or ought to be known by, a third person for whose acts the other party is responsible, the contract may be avoided under the same conditions as if the behaviour or knowledge had been that of the party itself.**

**(2) Where fraud, threat or gross disparity is imputable to a third person for whose acts the other party is not responsible, the contract may be avoided if that party knew or ought to have known of the fraud, threat or disparity, or has not at the time of avoidance reasonably acted in reliance on the contract.**

#### COMMENT

This Article deals with situations, frequent in practice, in which a third person has been involved or has interfered in the negotiation process, and the ground for avoidance is in one way or another imputable to that person.

##### **1. Third person for whom a party is responsible**

Paragraph (1) is concerned with cases in which fraud, threat, gross disparity or a party's mistake is caused by a third person for whose acts the other party is responsible, or cases in which, without causing the mistake, the third person knew or ought to have known of it. A party is responsible for the acts of a third person in a variety of situations ranging from those in which that person is an agent of the party in question to those where the third person acts for the benefit of that party on its own initiative. In all such cases it seems justified to impute to that party the third person's acts or its knowledge, whether actual or constructive, of certain circumstances, and this irrespective of whether the party in question knew of the third person's acts.

##### **2. Third person for whom a party is not responsible**

Paragraph (2) deals with cases where a party is defrauded, threatened or otherwise unduly influenced by a third person for whom the other party is not responsible. Such acts may be imputed to the latter party only if it knew or ought to have known of them.

There is however one exception to this rule: the defrauded, threatened or otherwise unduly influenced party is entitled to avoid the contract, even if the other party did not know of the third person's acts, whenever the other party has not reasonably acted in reliance on the contract before the time of avoidance. This exception is justified because in this situation the other party is not in need of protection.

**ARTICLE 3.2.9***(Confirmation)*

**If the party entitled to avoid the contract expressly or impliedly confirms the contract after the period of time for giving notice of avoidance has begun to run, avoidance of the contract is excluded.**

**COMMENT**

This Article lays down the rule according to which the party entitled to avoid the contract may either expressly or impliedly confirm the contract.

For there to be an implied confirmation it is not sufficient, for example, for the party entitled to avoid the contract to bring a claim against the other party based on the latter's non-performance. A confirmation can only be assumed if the other party acknowledges the claim or if a court action has been successful.

There is also confirmation if the party entitled to avoidance continues to perform the contract without reserving its right to avoid the contract.

**ARTICLE 3.2.10***(Loss of right to avoid)*

**(1) If a party is entitled to avoid the contract for mistake but the other party declares itself willing to perform or performs the contract as it was understood by the party entitled to avoidance, the contract is considered to have been concluded as the latter party understood it. The other party must make such a declaration or render such performance promptly after having been informed of the manner in which the party entitled to avoidance had understood the contract and before that party has reasonably acted in reliance on a notice of avoidance.**

**(2) After such a declaration or performance the right to avoidance is lost and any earlier notice of avoidance is ineffective.**

**COMMENT****1. Performance of the contract as understood by the mistaken party**

According to this Article a mistaken party may be prevented from avoiding the contract if the other party declares itself willing to perform or actually performs the contract as it was understood by the mistaken party. The interest of the other party in so doing may lie in the benefit to be derived from the contract, even in its adapted form.

Such regard for the interests of the other party is only justified in the case of mistake and not in other cases of defective consent (threat and fraud) where it would be extremely difficult to expect the parties to keep the contract alive.

**2. Decision to be made promptly**

The other party has to declare its decision to perform or actually to perform the contract in its adapted form promptly after having been informed of the manner in which the mistaken party had understood the contract. How the other party is to receive the information about the erroneous understanding of the terms of the contract will depend on the circumstances of the case.

**3. Loss of right to avoid**

Paragraph (2) expressly states that after the other party's declaration or performance the right of the mistaken party to avoid the contract is lost and that any earlier notice of avoidance becomes ineffective.

Conversely, the other party is no longer entitled to adapt the contract if the mistaken party has not only given notice of avoidance but has also reasonably acted in reliance on that notice.

**4. Damages**

The adaptation of the contract by the other party does not preclude the mistaken party from claiming damages in accordance with Article 3.2.16 if it has suffered loss which is not compensated by the adaptation of the contract.

**ARTICLE 3.2.11***(Notice of avoidance)*

**The right of a party to avoid the contract is exercised by notice to the other party.**

**COMMENT****1. The requirement of notice**

This Article states the principle that the right of a party to avoid the contract is exercised by notice to the other party without the need for any intervention by a court.

**2. Form and content of notice**

No provision is made in this Article for any specific requirement as to the form or content of the notice of avoidance. It follows that, in accordance with the general rule laid down in Article 1.10(1), the notice may be given by any means appropriate to the circumstances. As to the content of the notice, it is not necessary that the term “avoidance” actually be used, or that the reasons for avoiding the contract be stated expressly. However, for the sake of clarity a party would be well advised to give some reasons for the avoidance in its notice, although in cases of fraud or gross disparity the avoiding party may assume that those reasons are already known to the other party.

**Illustration**

A, B’s employer, threatens B with dismissal if B does not sell A a Louis XVI chest of drawers. B ultimately agrees to the sale. Two days later A receives a letter from B announcing B’s resignation and stating that B has sold the chest of drawers to C. B’s letter is sufficient notice of avoidance of the contract of sale with A.

**3. Notice must be received**

The notice of avoidance becomes effective when it reaches the other party (see Article 1.10(2)).

**ARTICLE 3.2.12***(Time limits)*

**(1) Notice of avoidance shall be given within a reasonable time, having regard to the circumstances, after the avoiding party knew or could not have been unaware of the relevant facts or became capable of acting freely.**

**(2) Where an individual term of the contract may be avoided by a party under Article 3.2.7, the period of time for giving notice of avoidance begins to run when that term is asserted by the other party.**

**COMMENT**

According to paragraph (1) of this Article notice of avoidance must be given within a reasonable time after the avoiding party became aware or could not have been unaware of the relevant facts or became capable of acting freely. More precisely, the mistaken or defrauded party must give notice of avoidance within a reasonable time after it became aware or could no longer be unaware of the mistake or fraud. The same applies in cases of gross disparity which result from an abuse of the innocent party's ignorance, improvidence or inexperience. In cases of threat or abuse of the innocent party's dependence, economic distress or urgent needs the period runs from the time the threatened or abused party becomes capable of acting freely.

In case of avoidance of an individual term of the contract in accordance with Article 3.2.7, paragraph (2) of this Article states that the period of time for giving notice begins to run when that term is asserted by the party.

**ARTICLE 3.2.13***(Partial avoidance)*

**Where a ground of avoidance affects only individual terms of the contract, the effect of avoidance is limited to those terms unless, having regard to the circumstances, it is unreasonable to uphold the remaining contract.**

**COMMENT**

This Article deals with situations where the grounds of avoidance affect only individual terms of the contract. In such cases the effects of avoidance will be limited to the terms affected unless it would in the circumstances be unreasonable to uphold the remaining contract. This will generally depend upon whether or not a party would have entered into the contract had it envisaged that the terms in question would have been affected by grounds of avoidance.

**Illustrations**

1. A, a contractor, agrees to build two houses on plots of land X and Y for B, one of which B intends to live in and the other to let. B was mistaken in assuming that it had a licence to build on both plots, since in fact the licence covered only plot X. Unless the circumstances indicate otherwise, notwithstanding the avoidance of the contract concerning the building of the house on plot Y, it would be reasonable to uphold the remaining contract concerning the building of the house on plot X.
2. The situation is the same as in Illustration 1, except that a school was to be built on plot X and living quarters for the students on plot Y. Unless the circumstances indicate otherwise, after the avoidance of the contract concerning the building of the living quarters on plot Y it would not be reasonable to uphold the remaining contract for the building of the school on plot X.

**ARTICLE 3.2.14**

*(Retroactive effect of avoidance)*

**Avoidance takes effect retroactively.****COMMENT**

This Article states the rule that avoidance takes effect retroactively. In other words, the contract is considered never to have existed. In the case of a partial avoidance under Article 3.2.13 the rule applies only to the avoided part of the contract.

There are however individual terms of the contract which may survive even in cases of total avoidance. Arbitration, jurisdiction and choice-of-law clauses are considered to be different from the other terms of the contract and may be upheld notwithstanding the avoidance of the contract in whole or in part. Whether in fact such clauses remain operative is to be determined by the applicable domestic law.



**ARTICLE 3.2.15***(Restitution)*

**(1) On avoidance either party may claim restitution of whatever it has supplied under the contract, or the part of it avoided, provided that such party concurrently makes restitution of whatever it has received under the contract, or the part of it avoided.**

**(2) If restitution in kind is not possible or appropriate, an allowance has to be made in money whenever reasonable.**

**(3) The recipient of the performance does not have to make an allowance in money if the impossibility to make restitution in kind is attributable to the other party.**

**(4) Compensation may be claimed for expenses reasonably required to preserve or maintain the performance received.**

**COMMENT****1. Right of parties to restitution on avoidance**

According to paragraph (1) of this Article either party may claim restitution of what the party has supplied under the contract or the part of it avoided. The only condition is that each party makes restitution of whatever the party has received under the contract or the part of it avoided.

**Illustration**

1. In the process of a takeover of a company, the controlling shareholder A agrees to sell and transfer to B shares for GBP 100,000. After discovering that A had fraudulently misstated the profits the company was earning, B avoids the contract. B can claim back the purchase price of GBP 100,000. At the same time, B has to return the shares received from A.

As regards the costs involved in making restitution, Article 6.1.11 applies.

**2. Restitution in kind not possible or appropriate**

Restitution must normally be in kind. There are, however, instances where instead of restitution in kind, an allowance in money has to be made. This is the case, first of all, where restitution in kind is not possible. The allowance will normally amount to the value of the performance received.

**Illustration**

2. A commissions B to paint A's factory. B had fraudulently induced A to conclude the contract at a price that is much higher than the market price. After having discovered the fraud, A avoids the contract. A can reclaim the purchase price from B while A is itself under a duty to pay for the value of having had its factory painted.

An allowance is further envisaged by paragraph (2) of this Article whenever restitution in kind would not be appropriate. This is so in particular when returning the performance in kind would cause unreasonable effort or expense. The standard, in that respect, is the same as under Article 7.2.2(b).

**Illustration**

3. Antiquarian A fraudulently induces antiquarian B to buy a collection of gold coins. The gold coins are reloaded onto one of B's ships. In a heavy storm the ship sinks. B subsequently discovers the fraud and avoids the contract. B can recover the price that it has paid, while itself having to make an allowance representing the value of the gold coins. This is in view of the fact that recovery of the gold coins from the sunken ship would involve expenses vastly exceeding their value.

The purpose of specifying that an allowance has to be made in money "whenever reasonable" is to make it clear that an allowance only has to be made if, and to the extent that, the performance received constitutes a benefit for the recipient.

**Illustration**

4. A has undertaken to decorate the entrance hall of B's business centre. After A has completed about half of the decorations B discovers that A is not the well-known decorator A has pretended to be. B avoids the contract. Since the decorations so far made cannot be returned and if they have no value for B, A is not entitled to any allowance for the work done.

### 3. The allocation of risk

The rule contained in paragraph (2) implies an allocation of risk: it imposes a liability on the recipient of the performance to make good the value of that performance if it is unable to make restitution in kind. The rule in paragraph (2) applies irrespective of whether the recipient was responsible for the deterioration or destruction of what it had received. This allocation of the risk of deterioration or destruction is justified, in particular, because the risk should lie with the person in control of the performance. On the contrary, there is no liability to make good the value if the deterioration or destruction is attributable to the other party, either because it was due to the other party's fault, or because it was due to a defect inherent in the performance. Hence the rule in paragraph (3).

#### Illustration

5. Art dealer A buys from art dealer B a painting which both of them believe to be a genuine Constable. Subsequently doubts arise about the authenticity of the painting. B undertakes to obtain an expert opinion by the well-known expert C. C confirms that the painting actually is from a much less well-known painter living at the time of Constable. Due to B's negligence, the painting is destroyed on the way back from C to A. A avoids the contract on the ground of a relevant mistake under Article 3.2.2. A can claim back the purchase price but does not have to make an allowance for the value of the painting.

The recipient's liability to pay the value of the performance received is not excluded in cases where the deterioration or destruction would also have occurred had the performance not been rendered.

#### Illustration

6. Company A sells and transfers earth-moving equipment to company B. The equipment is subsequently destroyed by a hurricane that floods the properties of both A and B. B avoids the contract because of a relevant mistake under Article 3.2.2. B can reclaim the purchase price but, at the same time, B has to make an allowance for the value of the earth-moving equipment.

Nor is the recipient's liability to make good the value of the performance excluded in cases where it has been led to conclude the contract by the other party's fraudulent representation.

**Illustration**

7. Antique dealer A has fraudulently induced garage owner B to swap A's ramshackle car against a valuable ancient Greek vase belonging to B. The car is accidentally destroyed while standing in B's garage. If B avoids the contract under Article 3.2.5, B can claim the vase back but has to make good the value of the car.

While Article 3.2.5 is intended to make sure that B is not bound by the contract that it has entered into (hence the right of avoidance) and that B is not saddled with the consequences of a bad bargain that A has induced B to make (hence the right to restitution), Article 3.2.5. does not protect B against accidents.

The question of the recipient's liability to pay the value of the performance only arises in cases where the deterioration or destruction occurs before avoidance of the contract. If what has been performed deteriorates or is destroyed after avoidance of the contract, the recipient of the performance is under a duty to return what the recipient has received. Any non-performance of that duty gives the other party a right to claim damages according to Article 7.4.1, unless the non-performance is excused under Article 7.1.7.

**Illustration**

8. Art dealer A buys from art dealer B a painting which both parties believe to be a genuine Constable. After it has become apparent that the painting actually is from a much less well-known painter living at the time of Constable, A avoids the contract on the ground of a relevant mistake under Article 3.2.2. As a result, A can reclaim the purchase price but is under a duty to return the painting. Before A can return the painting it is stolen by burglars. Whether B can claim damages depends on whether the burglary can be regarded as *force majeure* (see Article 7.1.7).

**4. Compensation for expenses**

If the recipient of a performance has incurred expenses for the preservation or maintenance of the object of the performance, it is reasonable to allow the recipient to claim compensation for these expenses in cases where the contract has been avoided and where, therefore, the parties have to return what they have received.

### Illustration

9. Company A has sold and delivered a race horse to company B. After some time B realizes that A has fraudulently concealed from him the true parentage of that horse. B avoids the contract. B can claim compensation for the costs incurred in feeding and caring for the horse.

This rule applies only to reasonable expenses. What is reasonable depends on the circumstances of the case. In Illustration 9 it would matter whether the horse had been sold as a race horse or as an ordinary farm horse.

Compensation cannot be claimed for expenses which are not required to preserve or maintain the performance received, even if they are reasonable.

### Illustration

10. Company A has sold and delivered a software package to company B which both parties believe to possess a certain functionality. When B discovers that this is not the case, B asks C to check whether that functionality can still be implemented. Since that turns out not to be possible, B avoids the contract for relevant mistake under Article 3.2.2. B cannot recover from A the fee paid to C as expenses under paragraph (4).

## 5. Benefits

The Principles do not take a position concerning benefits that have been derived from the performance, or interest that has been earned. In commercial practice it will often be difficult to establish the value of the benefits received by the parties as a result of the performance. Furthermore, often both parties will have received such benefits.

### ARTICLE 3.2.16

*(Damages)*

**Irrespective of whether or not the contract has been avoided, the party who knew or ought to have known of the ground for avoidance is liable for damages so as to put the other party in the same position in which it would have been if it had not concluded the contract.**

**COMMENT****1. Damages if ground for avoidance known to the other party**

This Article provides that a party which knew or ought to have known of a ground for avoidance is liable for damages to the other party. The right to damages arises irrespective of whether or not the contract has been avoided.

**2. The measure of damages**

Unlike the damages in case of non-performance under Chapter 7, Section 4, the damages contemplated by this Article are intended simply to put the other party in the position it would have been in if it had not concluded the contract.

**Illustration**

Company A sells software to company B and could not have been unaware of B's mistake as to its appropriateness for the use intended by B. Irrespective of whether or not B avoids the contract, A is liable to B for all the expenses incurred by B in training its personnel in the use of the software, but not for the loss suffered by B as a consequence of the impossibility to use the software for the intended purpose.

**ARTICLE 3.2.17**

*(Unilateral declarations)*

**The provisions of this Chapter apply with appropriate adaptations to any communication of intention addressed by one party to the other.**

**COMMENT**

This Article takes account of the fact that, apart from the contract itself, the parties, either before or after the conclusion of the contract, often exchange a number of communications of intention which may likewise be affected by invalidity

In a commercial setting, the most important example of unilateral communications of intention that are external, but preparatory, to a contract are bids for investment, works, delivery of goods or provision

of services. Communications of intention made after the conclusion of a contract take a variety of forms, such as notices, declarations, demands and requests. In particular, waivers and declarations by which a party assumes an obligation may be affected by a defect of consent.

## SECTION 3: ILLEGALITY

### ARTICLE 3.3.1

*(Contracts infringing mandatory rules)*

**(1) Where a contract infringes a mandatory rule, whether of national, international or supranational origin, applicable under Article 1.4 of these Principles, the effects of that infringement upon the contract are the effects, if any, expressly prescribed by that mandatory rule.**

**(2) Where the mandatory rule does not expressly prescribe the effects of an infringement upon a contract, the parties have the right to exercise such remedies under the contract as in the circumstances are reasonable.**

**(3) In determining what is reasonable regard is to be had in particular to:**

**(a) the purpose of the rule which has been infringed;**

**(b) the category of persons for whose protection the rule exists;**

**(c) any sanction that may be imposed under the rule infringed;**

**(d) the seriousness of the infringement;**

**(e) whether one or both parties knew or ought to have known of the infringement;**

**(f) whether the performance of the contract necessitates the infringement; and**

**(g) the parties' reasonable expectations.**

### COMMENT

#### 1. Scope of the Section

Despite its paramount importance (see Article 1.1), under the Principles freedom of contract is not without limit. Not only must parties conclude the contract without error and without constraints, also the contract must not violate the applicable mandatory rules. While defects of consent are dealt with in Section 2 of this Chapter, this



Section is concerned with a contract that infringes mandatory rules, whether by its terms, performance, purpose or otherwise. More precisely, this Section deals with the effects of that infringement on the contract by laying down the criteria to be followed in determining whether, despite the infringement, parties may still be granted remedies, and if so, whether there will be remedies under the contract (Article 3.3.1) or restitution (Article 3.3.2).

## **2. Only mandatory rules applicable under Article 1.4 relevant**

For the purpose of this Section, only mandatory rules, whether of national, international or supranational origin, that are applicable under Article 1.4 are relevant (see Comments 1 and 2 on Article 1.4). In other words, this Section is concerned only with a contract infringing mandatory rules, be they specific statutory provisions or unwritten general principles of public policy, which are applicable in accordance with the relevant rules of private international law. Which mandatory rules will be applicable in a given case basically depends on whether the dispute is pending before a domestic court or an arbitral tribunal, and on whether the parties' reference to the Principles is considered to be only an agreement to incorporate them in the contract or whether the Principles are applied as the law governing the contract (see Comments 3, 4 and 5 on Article 1.4). Note that the Illustrations below do not address these questions and are based on the assumption that the mandatory rules referred to apply in the cases illustrated.

## **3. Ways in which a contract may infringe mandatory rules**

A contract may infringe mandatory rules first of all by its very terms. As shown by the following Illustrations concerning corruption and collusive bidding, mandatory rules may be specific statutory provisions or unwritten general principles of public policy.

### **Illustrations**

1. Contractor A of country X enters into an agreement with agent B ("the Commission Agreement") under which B, for a fee of USD 1,000,000, would pay USD 10,000,000 to C, a high-ranking procurement advisor of D, the Minister of Economics and Development of country Y, in order to induce D to award A the contract for the construction of a new power plant in country Y ("the Contract"). In both countries X and Y bribery of public officials is prohibited by statute. The Commission Agreement infringes the statutory prohibitions in question by its terms. As to the Contract for the construction of the power plant, see Illustration 7.

2. Contractor A of country X enters into an agreement with agent B (“the Commission Agreement”) to pay EUR 100,000 to C, a high ranking officer of company D of country Y, in order to induce D to award A the contract for the installation of a sophisticated IT system. Neither in country X nor in country Y is bribery in the private sector prohibited by statute but in both countries it is considered contrary to public policy. The Commission Agreement violates these principles of public policy by its terms.

3. Bidders A and B of countries X and Y respectively enter into an agreement (“the Collusive Bidding Agreement”) according to which in a series of public tendering proceedings for the procurement of construction contracts in country Z, they would collude so that A would get some of the contracts and B the others. A statutory regulation of country Z prohibits collusive bidding in public tendering proceedings. The Collusive Bidding Agreement infringes the statutory prohibition by its terms.

4. Bidders A and B of countries X and Y respectively enter into an agreement (“the Collusive Bidding Agreement”) according to which in a series of public tendering proceedings for the procurement of construction contracts in country Z, they would collude so that A would get some of the contracts and B the others. In country Z there is no statutory regulation prohibiting collusive bidding in public tendering proceedings but collusive bidding is considered contrary to public policy. The Collusive Bidding Agreement violates this principle of public policy by its terms.

A contract may also by its performance infringe mandatory rules.

### **Illustrations**

5. A, a large-scale retailer in country X, enters into an agreement with B, a manufacturer in country Y, for the manufacture of toys according to its specifications (“the Manufacture Agreement”). A knew or ought to have known that the toys ordered would be manufactured by child labourers. In both country X and country Y child labour is considered contrary to public policy. The Manufacture Agreement violates these principles of public policy by its performance.

6. Importer A from country X enters into an agreement with exporter B from country Y for the supply of equipment. After the conclusion of the contract, the United Nations imposes an embargo on the importation of such type of equipment into country X. B nevertheless delivers the equipment in violation of

the embargo. The agreement between A and B violates the embargo by its performance.

Moreover, a contract may also infringe mandatory rules in other ways, for example by the way in which it is formed or by its purpose.

#### Illustrations

7. The facts are the same as in Illustration 1, except that B pays C the USD 10,000,000 bribe and D awards the Contract to A. The Contract violates the statutes prohibiting corruption by the way in which it is formed.

8. A, a manufacturer of plastic explosives situated in country X, enters into an agreement with B, a trading company situated in country Y, for the supply of quantities of semtex, a material useful for peaceful purposes as well as for the manufacture of bombs (“the Supply Agreement”). A knew or ought to have known that B would ultimately forward the goods to a terrorist organisation. The Supply Agreement violates the fundamental principle of public policy prohibiting the support of terrorist activities by its purpose.

#### **4. Effects of infringement expressly prescribed by the mandatory rule infringed**

Sometimes the mandatory rule itself expressly states which contractual or restitutionary remedies, if any, are available to the parties in case of its infringement. Thus, for instance, Article 101(2) of the Treaty on the European Union (former Article 85(2) of the Treaty of Rome) expressly states that anti-competitive agreements between enterprises which may affect trade between member States of the European Union prohibited under Article 101(1) “shall be automatically void”. Similarly the UNIDROIT Convention on Stolen or Illegally Exported Cultural Objects provides that “[a] Contracting State may request [...] the return of a cultural object illegally exported from the territory of the requesting State” (Article 5) and that “[t]he possessor of a cultural object who acquired the object [...] illegally exported shall be entitled [...] to payment by the requesting State of fair and reasonable compensation, provided that [it] neither knew nor ought reasonably to have known at the time of acquisition that the object had been illegally exported” (Article 6).

**5. Effects of infringement to be determined according to what is reasonable in the circumstances**

If the mandatory rule does not expressly provide for the effects of its infringement upon the contract, paragraph (2) provides that the parties may exercise “such remedies under the contract as in the circumstances are reasonable”. The formula used is sufficiently broad to permit a maximum of flexibility. Thus, notwithstanding the infringement of the mandatory rule, one or both of the parties may, depending on the circumstances of the case, be granted the ordinary remedies available under a valid contract (including the right to performance), or other remedies such as the right to treat the contract as being of no effect, the adaptation of the contract or its termination on terms to be fixed. The latter kind of remedies may be particularly appropriate where as a consequence of the infringement only part of the contract becomes ineffective. As to the granting of restitution of the performances rendered under a contract infringing a mandatory rule, see Article 3.3.2.

**6. Criteria for determining what is reasonable in the circumstances**

Given the great variety of mandatory rules which may be relevant under this Article, ranging from regulations of a merely technical nature to prohibitions for the purpose of preventing grave social harm, paragraph (3) provides a list of criteria to determine the contractual remedies available in the circumstances, if any. The list is not exhaustive. In many cases more than one of the criteria will be relevant and the decision will involve a weighing of these criteria.

*a. Purpose of the rule infringed*

Among the most important factors to be taken into consideration is the purpose of the mandatory rule and whether the attaining of its purpose would or would not be affected by granting at least one of the parties a remedy under the contract.

**Illustrations**

9. The facts are the same as in Illustration 1, except that even though B paid C A's bribe, D does not award the Contract to A. Since the purpose of the relevant statutory prohibition of bribery would be frustrated by granting A and B any remedy under the Commission Agreement, B may not request the payment of the USD 1,000,000 fee from A, nor may A recover from B the USD 10,000,000 B has paid to C.

10. A, an aircraft manufacturer in country X, knowing that C, the Ministry of Defence of country Y, intends to purchase a number of military aircraft, enters into an agreement with B, a consultancy firm located in country Y, by which B is to negotiate the possible purchase by C of the aircraft manufactured by A (“the Agency Agreement”). A statutory regulation of country Y prohibits the employment of intermediaries in the negotiation and conclusion of contracts with governmental agencies. Since the purpose of the statutory prohibition of the employment of intermediaries is to fight corruption, neither A nor B should be granted any remedy under the Agency Agreement.

11. The facts are the same as in Illustration 6. Since the purpose of the embargo is to impose a sanction on country X following X’s violation of international law, the attaining of that purpose requires that all contracts concluded or performed in violation of the embargo have no effect and that parties be denied any remedy under such contracts.

*b. Category of persons to be protected by the rule infringed*

Another important factor to be taken into consideration is whether the mandatory rule that is infringed is aimed at protecting the interests of the public in general or those of a specific category of persons. Licensing requirements are often of the latter type, i.e. are imposed by law on those carrying out certain activities for the protection of their customers or clients. If a contract is entered into by an unlicensed party it might be reasonable to grant its customer or client at least some remedies under the contract such as damages.

**Illustration**

12. Company A in country X enters into an agreement with engineer B in country Y for the preparation of plans for the restructuring of A’s factory (“the Engineering Contract”). A statutory regulation of country X requires that only licensed engineers carry out this activity. B, who does not have the necessary license, delivers plans that are in part based on erroneous calculations causing a delay in the restructuring work. Requested by A to pay damages for the loss caused by the delay, B refuses to pay on the ground that the Engineering Contract was invalid as B lacked the required license. Since the purpose of the license requirement is the protection of the clients, A may be granted the right to damages.

*c. Any sanction that may be imposed under the rule infringed*

Statutory regulations prohibiting certain activities or imposing limitations to certain activities often provide criminal or administrative sanctions. As noted in Comment 4, when such a regulation expressly states the effect of violation on contractual rights or remedies, that statement controls. When the regulation is silent as to that effect, however, the existence and nature of the criminal or administrative sanctions can provide important insight into the purpose of the rule that has been violated, the category of persons for whose protection the rule exists, and the seriousness of the violation. Accordingly, the existence and nature of these sanctions should be taken into consideration in determining the effect of such a violation on contractual rights and remedies.

**Illustration**

13. A, an exporter in country X, enters into a contract of carriage with B, a ship-owner in country Y, to carry goods by sea from country X to country Y (“the Contract”). A statutory regulation in country X imposes limits on the loads that ships may carry. The statutory regulation provides for a fine in the case of its violation but it says nothing about the effects a violation would have on the individual contracts of carriage. B overloads the ship and A, claiming the invalidity of the Contract, refuses to pay the freight notwithstanding the fact that the goods had arrived safely. Since the purpose of the statutory regulation is to prevent, in the interests of the safety of the ship and its crew, overloading and not to prohibit contracts, and this purpose is sufficiently achieved by the fining of B, B may be granted the right to be paid the agreed freight for the carriage of the goods.

*d. Seriousness of infringement*

Another factor to be taken into consideration is the seriousness of the infringement. Thus, remedies under the contract may be granted where the mandatory rule is of a purely technical nature and its infringement has no impact on the other party.

**Illustrations**

14. Cattle farmer A in country X sells cattle to cattle farmer B in country Y. A statutory regulation in country Y requires incoming cattle to be properly tagged and that the information contained on the tags also be set out in accompanying documents. The cattle delivered is properly tagged but the accompanying documents are

incomplete. A may nevertheless be granted the right to payment of the price.

15. A, an exporter in country X, enters into a contract with B, a carrier from country Y, for the carriage of dangerous goods from country X to country Y (“the Contract”). Country X has a statutory regulation requiring goods of the kind in question to be carried on a vehicle with particular safety requirements. The statutory regulation provides a criminal sanction in case of violation but says nothing about the effects a violation would have on the individual contracts of carriage. B carries the goods on a vehicle that does not meet the prescribed safety requirements. A, claiming the invalidity of the Contract, refuses to pay the freight notwithstanding the fact that the goods arrived safely. Since the purpose of the statutory regulations is the prevention of injury to third persons or damage to the environment, B, irrespective of the imposition of the criminal sanction, should not be granted the right to be paid the agreed freight.

*e. Whether one or both parties knew or ought to have known of the infringement*

Granting remedies under the contract may also depend on whether one or even both of the parties knew or ought to have known of the mandatory rule or of its infringement.

**Illustrations**

16. The facts are the same as in Illustration 1, except that B has paid the bribe to C and D, who neither knew nor ought to have known of the bribe to C, awarded the Contract to A. If D subsequently becomes aware of the payment of the bribe, D may choose whether or not to treat the Contract as effective. If D chooses to treat the Contract as effective, A will be obliged to perform and D will have to pay the price, subject to an appropriate adjustment taking into consideration the payment of the bribe. If, on the other hand, D chooses to treat the Contract as being of no effect, neither of the parties has a remedy under the Contract. This is without prejudice to any restitutionary remedy that may exist.

17. Contractor A of country X enters into negotiations with D, the Minister of Economics and Development of country Y, with a view to conclude an agreement on a large infrastructure project (“the Contract”). D requests the payment of a “commission” of 7.5% of the contract price in order to conclude the Contract. A pays the requested “commission” and the Contract is concluded. When A has already performed half of its obligations under the

Contract, a new Government comes to power in country Y and the new Minister of Economics and Development, invoking the payment of the “commission”, cancels the project and refuses to pay for the work already performed. A is not entitled to any remedy under the Contract. This is without prejudice to any restitutionary remedy that may exist.

f. *Whether the performance of the contract necessitates the infringement*

Another factor to be taken into consideration is whether the performance of the contract necessitates the infringement. Thus, if by its very terms the contract provides for, or even only implicitly involves, the violation of a statutory regulation it might be reasonable not to grant the parties any remedy under the contract.

Illustration

18. Company A of country X enters into a contract with company B of country Y for the construction of a chemical fertilizer production plant in country Y (“the Contract”). The Contract does not provide for the installation of the safety devices required by the environmental protection laws of country Y and the parties deliberately agree on a price insufficient to cover the costs of the installation of the devices in question. Neither A nor B should be granted any remedy under the contract.

g. *The parties’ reasonable expectations*

If one of the parties on account of different legal or commercial culture could not have reasonably been aware of the infringement or, as is more often the case, one of the parties creates a legitimate expectation as to the enforceability of the contract or its individual terms and later invokes a statutory prohibition of its own law in order to nullify that expectation, it might be reasonable to grant the other party the remedies available under the contract or its individual terms.

Illustration

19. Company A of country X enters into an agreement with B, the Minister of Economics and Development of country Y, concerning an investment project in country Y (“the Agreement”). The Agreement contains a clause providing that all disputes arising out of the Agreement should be decided by arbitration to be held in country Z in accordance with the UNCITRAL Arbitration Rules. If a dispute subsequently arises and A commences arbitration proceedings, B, with a view to



avoiding arbitration, cannot invoke a mandatory rule of country Y according to which the domestic courts of country Y have exclusive jurisdiction which may not be contractually excluded by an arbitration agreement for disputes relating to contracts of the type of the Agreement.

*h. Other criteria*

In addition to the criteria expressly listed in paragraph (3) of this Article, there are others which may be taken into consideration to determine the remedies available in the circumstances, if any. One criterion is the extent to which the contract infringes the mandatory rule. If the contract infringes the mandatory rule only in part, it may be reasonable to adapt the contract and grant the parties remedies under it.

**Illustration**

20. The facts are the same as in Illustration 5, except that only one specific type of toy ordered by A is manufactured by child labourers in their homes, while all the other types are manufactured by workers lawfully employed by B in its factory. Under the circumstances it may be reasonable to adapt the Manufacture Agreement accordingly and grant the parties the ordinary remedies under the adapted Manufacture Agreement.

Another factor is the timely withdrawal from the improper transaction. Thus, if a party to a contract infringing a mandatory rule repents of its action before the unlawful purpose of the contract has been achieved, that party may be granted the right to recover what it has performed.

**Illustration**

21. The facts are the same as in Illustration 1, except that A, after having paid B the agreed fee of USD 1,000,000, but before B pays C the USD 10,000,000 bribe, decides no longer to pursue the illegal purpose and withdraws from the Contract. A may be granted the right to recover the fee from B.

**ARTICLE 3.3.2***(Restitution)*

(1) Where there has been performance under a contract infringing a mandatory rule under Article 3.3.1, restitution may be granted where this would be reasonable in the circumstances.

(2) In determining what is reasonable, regard is to be had, with the appropriate adaptations, to the criteria referred to in Article 3.3.1(3).

(3) If restitution is granted, the rules set out in Article 3.2.15 apply with appropriate adaptations.

**COMMENT****1. Restitution under contracts infringing mandatory rules to be granted where reasonable under the circumstances**

Even where as a consequence of the infringement of a mandatory rule the parties are denied any remedies under the contract, it remains to be seen whether they may at least claim restitution of what they have rendered in performing the contract. According to Article 3.3.1(1), the answer first of all depends on the mandatory rule itself which may or may not expressly address the issue (see also Comment 4 on Article 3.3.1).

If the mandatory rule is silent on the issue, this Article, in line with the modern trend, adopts a flexible approach and provides that where there has been performance under a contract infringing a mandatory rule, restitution may be granted if this would be reasonable in the circumstances (paragraph 1). In other words, contrary to the traditional view that, at least where both parties were aware or ought to have been aware of the infringement of the mandatory rule, they should be left where they stand, i.e. should not even be entitled to recover the benefits conferred, under the Principles restitution may or may not be granted depending on whether it is more appropriate to allow the recipient to keep what it has received or to allow the performer to reclaim it.

## 2. Criteria for determining whether granting of restitution reasonable

The same criteria laid down in paragraph (3) of Article 3.3.1 to determine if any contractual remedies are available in the circumstances, if any, apply to determine whether granting restitution under paragraph (1) of this Article is reasonable. However, since the contractual and restitutionary remedies are different, the same criteria may lead to different results under the same facts.

### Illustrations

1. The facts are the same as in Illustration 1 in the Comments on Article 3.3.1, except that A, having been awarded the Contract, had almost completed the construction of the power plant when in country Y a new Government comes to power which claims that the Contract is invalid because of corruption and refuses to pay the outstanding 50% of the price. Under the circumstances it would not be fair to let D have the almost completed power plant for half the agreed price. A may be granted an allowance in money for the work done corresponding to the value that the almost completed power plant has for D and D may be granted restitution of any payment it has made exceeding this amount.
2. Contractor A of country X enters into negotiations with D, the Minister of Economics and Development of country Y, with a view of concluding an agreement on a large infrastructure project ("the Contract"). D requests the payment of a "commission" of 7.5% of the contract price in order to conclude the Contract. A pays the requested "commission" and the Contract is concluded. After A has fulfilled all of its obligations under the Contract, a new Government comes to power in country Y and the new Minister of Economics and Development, invoking the payment of the "commission", refuses to pay the remaining contract price. A may be granted an allowance in money for the work done corresponding to the value of the infrastructure project.
3. The facts are the same as in Illustration 15 in the Comments on Article 3.3.1, except that B, given that the goods had arrived safely at destination, claims the recovery of at least the value of its service. Under the circumstances, i.e. in view of the seriousness of the violation and the necessity of preventing by all means the carriage of dangerous goods by vehicles lacking the required safety requirements, B may not even be granted the right to recover the value of its service.

**3. Rules governing restitution if granted**

If restitution is granted under this Article it is governed by the rules set out in Article 3.2.15 on restitution in the context of avoidance. These rules however need some adaptations, in the sense that in paragraph (1) of Article 3.2.15 the reference to avoidance is to be understood as a reference to the case where the contract becomes ineffective as a result of the infringement of a mandatory rule, and the reference to avoidance of part of the contract as a reference to the case where only part of the contract becomes ineffective as a result of the infringement of a mandatory rule. For further explanation of the rules on restitution referred to in this Article, see the Comments on Article 3.2.15.

## CHAPTER 4

### INTERPRETATION

#### ARTICLE 4.1

*(Intention of the parties)*

**(1) A contract shall be interpreted according to the common intention of the parties.**

**(2) If such an intention cannot be established, the contract shall be interpreted according to the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances.**

#### COMMENT

##### **1. Common intention of the parties to prevail**

Paragraph (1) of this Article lays down the principle that in determining the meaning to be attached to the terms of a contract, preference is to be given to the intention common to the parties. In consequence, a contract term may be given a meaning which differs both from the literal sense of the language used and from the meaning which a reasonable person would attach to it, provided that such a different understanding was common to the parties at the time of the conclusion of the contract.

The practical importance of the principle should not be over-estimated, firstly because parties to commercial transactions are unlikely to use language in a sense entirely different from that usually attached to it, and secondly because even if this were to be the case it would be extremely difficult, once a dispute arises, to prove that a particular meaning which one of the parties claims to have been their common intention was in fact shared by the other party at the time of the conclusion of the contract.

**2. Recourse to the understanding of reasonable persons**

For those cases where the common intention of the parties cannot be established, paragraph (2) provides that the contract shall be interpreted in accordance with the meaning which reasonable persons of the same kind as the parties would give to it in the same circumstances. The test is not a general and abstract criterion of reasonableness, but rather the understanding which could reasonably be expected of persons with, for example, the same linguistic knowledge, technical skill, or business experience as the parties.

**3. How to establish the common intention of the parties or to determine the understanding of reasonable persons**

In order to establish whether the parties had a common intention and, if so, what that common intention was, regard is to be had to all the relevant circumstances of the case, the most important of which are listed in Article 4.3. The same applies to the determination of the understanding of reasonable persons when no common intention of the parties can be established.

**4. Interpretation of standard terms**

Both the “subjective” test laid down in paragraph (1) and the “reasonableness” test in paragraph (2) may not always be appropriate in the context of standard terms. Indeed, given their special nature and purpose, standard terms should be interpreted primarily in accordance with the reasonable expectations of their average users irrespective of the actual understanding which either of the parties to the contract concerned, or reasonable persons of the same kind as the parties, might have had. For the definition of “standard terms”, see Article 2.1.19(2).

**ARTICLE 4.2**

*(Interpretation of statements and other conduct)*

**(1) The statements and other conduct of a party shall be interpreted according to that party’s intention if the other party knew or could not have been unaware of that intention.**

**(2) If the preceding paragraph is not applicable, such statements and other conduct shall be interpreted according to the meaning that a reasonable person of the same kind as the other party would give to it in the same circumstances.**

#### COMMENT

##### **1. Interpretation of unilateral acts**

By analogy to the criteria laid down in Article 4.1 with respect to the contract as a whole, this Article states that in the interpretation of unilateral statements or conduct preference is to be given to the intention of the party concerned, provided that the other party knew (or could not have been unaware) of that intention, and that in all other cases such statements or conduct are to be interpreted according to the understanding that a reasonable person of the same kind as the other party would have had in the same circumstances.

In practice the principal field of application of this Article, which corresponds almost literally to Article 8(1) and (2) CISG, will be in the process of the formation of contracts where parties make statements and engage in conduct the precise legal significance of which may have to be established in order to determine whether or not a contract is ultimately concluded. There are however also unilateral acts performed after the conclusion of the contract which may give rise to problems of interpretation: for example, a notification of defects in goods, notice of avoidance or of termination of the contract, etc.

##### **2. How to establish the intention of the party performing the act or to determine the understanding of a reasonable person**

In applying both the “subjective” test laid down in paragraph (1) and the “reasonableness” test in paragraph (2), regard is to be had to all the relevant circumstances, the most important of which are listed in Article 4.3.

**ARTICLE 4.3***(Relevant circumstances)*

**In applying Articles 4.1 and 4.2, regard shall be had to all the circumstances, including**

**(a) preliminary negotiations between the parties;**

**(b) practices which the parties have established between themselves;**

**(c) the conduct of the parties subsequent to the conclusion of the contract;**

**(d) the nature and purpose of the contract;**

**(e) the meaning commonly given to terms and expressions in the trade concerned;**

**(f) usages.**

**COMMENT****1. Circumstances relevant in the interpretation process**

This Article indicates circumstances which have to be taken into consideration when applying both the “subjective” test and the “reasonableness” test in Articles 4.1 and 4.2. The list mentions only those circumstances which are the most important and is in no way intended to be exhaustive.

**2. “Particular” and “general” circumstances compared**

Of the circumstances listed in this Article some relate to the particular relationship which exists between the parties concerned, while others are of a more general character. Although in principle all the circumstances listed may be relevant in a given case, the first three are likely to have greater weight in the application of the “subjective” test.

**Illustrations**

1. A contract for the writing of a book between A and B, a publisher, indicates that the book should consist of “about 300 pages”. During their negotiations B had assured A that an approximate indication of the number of pages was necessary for administrative reasons and that A was not bound to stick precisely to that number of pages, but could exceed it, substantially if need



be. A submits a manuscript of 500 pages. In interpreting the meaning of “about 300 pages” due consideration should be given to these preliminary negotiations (see Article 4.3(a)).

2. A, a Canadian manufacturer, and B, a United States retailer, conclude a number of contracts for the delivery of optical lenses in which the price is always expressed in Canadian dollars. A makes B a new offer indicating the price in “dollars” without further specification, but intending to refer again to Canadian dollars. In the absence of any indication to the contrary, A’s intention will prevail (see Article 4.3(b)).

The remaining circumstances listed in this Article, i.e. the nature and purpose of the contract, the meaning commonly given to terms and expressions in the trade concerned and usages, are important primarily, although not exclusively, in the application of the “reasonableness” test.

The criteria in sub-paragraphs (e) and (f) may at first sight appear to overlap. There is however a difference between them: while the “usages” apply only if they meet the requirements laid down in Article 1.9, the “meaning commonly given [...] in the trade concerned” can be relevant even if it is peculiar to a trade sector to which only one, or even neither, party belongs, provided that the expression or term concerned is one which is typical in that trade sector.

### Illustrations

3. A and B conclude a contract for the sale of a cargo of oil at USD 80 per barrel. The parties subsequently disagree on the size of the barrel to which they had referred, A having intended a barrel of 42 standard gallons and B one of 36 Imperial gallons. In the absence of any indications to the contrary, A’s understanding prevails, since in the international oil trade it is a usage to measure barrels in standard gallons (see Article 4.3(f)).

4. A, a shipowner, concludes a charterparty agreement with B for the carriage of grain containing the standard term “whether in berth or not” with respect to the commencement of the lay-time of the ship after its reaching the port of destination. When it subsequently emerges that the parties attached different meanings to the term, preference should, in the absence of any indication to the contrary, be given to the meaning commonly attached to it in the shipping trade since the term is typical in the shipping trade (see Article 4.3(e)).

**3. “Merger” clauses**

Parties to international commercial transactions frequently include a provision indicating that the contract document completely embodies the terms on which they have agreed. For the effect of these so-called “merger” or “integration” clauses, in particular whether and to what extent they exclude the relevance of preliminary negotiations between the parties, albeit only for the purpose of the interpretation of the contract, see Article 2.1.17.

**ARTICLE 4.4**

*(Reference to contract or statement as a whole)*

**Terms and expressions shall be interpreted  
in the light of the whole contract or statement in  
which they appear.**

**COMMENT****1. Interpretation in the light of the whole contract or statement**

Terms and expressions used by one or both parties are clearly not intended to operate in isolation but have to be seen as an integral part of their general context. Consequently they should be interpreted in the light of the whole contract or statement in which they appear.

**Illustration**

A, a licensee, hears that, despite a provision in their contract granting A an exclusive licence, B, the licensor, has concluded a similar contract with C, one of A’s competitors. A sends B a letter complaining of B’s breach and ending with the words “your behaviour has clearly demonstrated that it was a mistake on our part to rely on your professional correctness. We hereby avoid the contract we have with you”. Despite the use of the term “avoid”, A’s words interpreted in the light of the letter as a whole, must be understood as a notice of termination.

**2. In principle no hierarchy among contract terms**

In principle there is no hierarchy among contract terms, in the sense that their respective importance for the interpretation of the remaining part of the contract is the same regardless of the order in which

they appear. There are, however, exceptions to this rule. Firstly, declarations of intent made in the preamble may or may not be of relevance for the interpretation of the operative provisions of the contract. Secondly, it goes without saying that, in cases of conflict, provisions of a specific character prevail over provisions laying down more general rules. Finally, the parties may themselves expressly establish a hierarchy among the different provisions or parts of their contract. This is frequently the case with complex agreements consisting of different documents relating to the legal, economic and technical aspects of the transaction.

#### ARTICLE 4.5

*(All terms to be given effect)*

**Contract terms shall be interpreted so as to give effect to all the terms rather than to deprive some of them of effect.**

#### COMMENT

It is to be expected that when drafting their contract parties do not use words to no purpose. It is for this reason that this Article lays down the rule that unclear contract terms should be interpreted so as to give effect to all the terms rather than to deprive some of them of effect. The rule however comes into play only if the terms in question remain unclear notwithstanding the application of the basic rules of interpretation laid down in Articles 4.1 to 4.3.

#### Illustration

A, a commercial television network, enters into an agreement with B, a film distributor, for the periodic supply of a certain number of films to be transmitted on A's network in the afternoon, when only those films that are admissible for all viewers may be transmitted. According to the contract the films submitted must "have passed the admission test" of the competent censorship commission. A dispute arises between A and B as to the meaning of this term. B maintains that it implies only that the films must have been released for circulation, even if they are X-rated, while A insists that they must have been classified as admissible for everybody. If it is not possible otherwise to establish the meaning to be attached to the term in question, A's understanding prevails since B's interpretation would deprive the provision of any effect.

**ARTICLE 4.6***(Contra proferentem rule)*

**If contract terms supplied by one party are unclear, an interpretation against that party is preferred.**

**COMMENT**

A party may be responsible for the formulation of a particular contract term, either because that party has drafted it or otherwise supplied it, for example, by using standard terms prepared by others. Such a party should bear the risk of possible lack of clarity of the formulation chosen. It is for this reason that this Article states that if contract terms supplied by one party are unclear, there is a preference for their interpretation against that party. The extent to which this rule applies will depend on the circumstances of the case; the less the contract term in question was the subject of further negotiations between the parties, the greater the justification for interpreting it against the party who included it in the contract.

**Illustration**

A contract between A, a contractor, and B for the construction of an industrial plant contains a provision drafted by A and not discussed further stating that “[t]he Contractor shall be liable for and shall indemnify the Purchaser for all losses, expenses and claims in respect of any loss of or damage to physical property (other than the works), death or personal injury caused by negligence of the Contractor, its employees and agents”. One of A’s employees plays around with some of B’s equipment after working hours and damages it. A denies liability, contending that the provision in question covers only cases where A’s employees act within the scope of their employment. In the absence of any indication to the contrary, the provision will be interpreted in the manner which is less favourable to A, i.e. as also covering cases where its employees are not acting within the scope of their employment.

**ARTICLE 4.7**

*(Linguistic discrepancies)*

**Where a contract is drawn up in two or more language versions which are equally authoritative there is, in case of discrepancy between the versions, a preference for the interpretation according to a version in which the contract was originally drawn up.**

**COMMENT**

International commercial contracts are often drawn up in two or more language versions which may diverge on specific points. Sometimes the parties expressly indicate which version shall prevail. If all versions are equally authoritative the question arises of how possible discrepancies should be dealt with. This Article does not lay down a hard and fast rule, but merely indicates that preference should be given to the version in which the contract was originally drawn up or, should it have been drawn up in more than one original language version, to one of those versions.

**Illustration**

1. A and B, neither of them a native English speaker, negotiate and draw up a contract in English before translating it into their respective languages. The parties agree that all three versions are equally authoritative. In case of divergences between the texts, the English version will prevail unless circumstances indicate the contrary.

A situation where a different solution may be preferable could arise where the parties have contracted on the basis of internationally and widely known instruments such as INCOTERMS or the *Uniform Customs and Practices on Documentary Credits*. In case of divergencies between the different versions used by the parties it may be preferable to refer to yet another version if that version is much clearer than the ones used.

**Illustration**

2. A contract between a company from country X and a company from country Y drawn up in three equally authoritative versions, the language of country X, the language of country Y and English,

contains a reference to INCOTERMS 2000. If the French version of INCOTERMS is much clearer than the other three on a point in dispute, that version might be referred to.

**ARTICLE 4.8**

*(Supplying an omitted term)*

**(1) Where the parties to a contract have not agreed with respect to a term which is important for a determination of their rights and duties, a term which is appropriate in the circumstances shall be supplied.**

**(2) In determining what is an appropriate term regard shall be had, among other factors, to**

- (a) the intention of the parties;**
- (b) the nature and purpose of the contract;**
- (c) good faith and fair dealing;**
- (d) reasonableness.**

**COMMENT****1. Supplying of omitted terms and interpretation**

Articles 4.1 to 4.7 deal with the interpretation of contracts in the strict sense, i.e. with the determination of the meaning which should be given to contract terms which are unclear. This Article addresses a different though related issue, namely that of the supplying of omitted terms. Omitted terms or gaps occur when, after the conclusion of the contract, a question arises which the parties have not regulated in their contract at all, either because they preferred not to deal with it or simply because they did not foresee it.

**2. When omitted terms are to be supplied**

In many cases of omitted terms or gaps in the contract the Principles will themselves provide a solution to the issue (see, for example, Articles 5.1.6 (*Determination of quality of performance*), 5.1.7 (*Price determination*), 6.1.1 (*Time of performance*), 6.1.4 (*Order of performance*), 6.1.6 (*Place of performance*) and 6.1.10

(*Currency not expressed*). See also, in general, Article 5.1.2 on implied obligations). However, even when there are such suppletive, or “stop-gap”, rules of a general character they may not be applicable in a given case because they would not provide a solution appropriate in the circumstances in view of the expectations of the parties or the special nature of the contract. This Article then applies.

### 3. Criteria for the supplying of omitted terms

The terms supplied under this Article must be appropriate to the circumstances of the case. In order to determine what is appropriate, regard is first of all to be had to the intention of the parties as inferred from, among other factors, the terms expressly stated in the contract, prior negotiations or any conduct subsequent to the conclusion of the contract.

#### Illustration

1. The parties to a construction contract agree on a special interest rate to be paid by the purchaser in the event of delay in payment of the price. Before the beginning of the work, the parties decide to terminate the contract. When the constructor delays restitution of the advance payment the question arises of the applicable interest rate. In the absence of an express term in the contract dealing with this question, the circumstances may make it appropriate to apply the special interest rate agreed for delay in payment of the price by the purchaser also to delay in restitution by the constructor.

If the intention of the parties cannot be ascertained, the term to be supplied may be determined in accordance with the nature and purpose of the contract, and the principles of good faith and fair dealing and reasonableness.

#### Illustration

2. A distribution franchise agreement provides that the franchisee may not engage in any similar business for a year after the termination of the agreement. Although the agreement is silent on the territorial scope of this prohibition, it is, in view of the particular nature and purpose of the franchise agreement, appropriate that the prohibition be restricted to the territory where the franchisee had exploited the franchise.

## CHAPTER 5

### CONTENT, THIRD PARTY RIGHTS AND CONDITIONS

#### SECTION 1: CONTENT

##### ARTICLE 5.1.1

*(Express and implied obligations)*

**The contractual obligations of the parties  
may be express or implied.**

##### COMMENT

This provision restates the widely accepted principle according to which the obligations of the parties are not necessarily limited to that which has been expressly stipulated in the contract. Other obligations may be implicit (see Article 5.1.2, Comments and Illustrations).

Close links exist between this Article and some of the other provisions of the Principles. Thus Article 5.1.1 is a direct corollary of the rule according to which “[e]ach party must act in accordance with good faith and fair dealing in international trade” (Article 1.7). Insofar as the rules on interpretation (Chapter 4) provide criteria for filling lacunae (besides criteria for solving ambiguities), those rules may assist in determining the precise content of the contract and therefore in establishing the terms which must be considered as implied.

##### ARTICLE 5.1.2

*(Implied obligations)*

**Implied obligations stem from**

- (a) the nature and purpose of the contract;**
- (b) practices established between the parties and usages;**
- (c) good faith and fair dealing;**
- (d) reasonableness.**



**COMMENT**

This Article describes the sources of implied obligations. Different reasons may account for the fact that they have not been expressly stated. The implied obligations may for example have been so obvious, given the nature or the purpose of the obligation, that the parties felt that the obligations “went without saying”. Alternatively, they may already have been included in the practices established between the parties or prescribed by trade usages according to Article 1.9. Yet again, they may be a consequence of the principles of good faith and fair dealing and reasonableness in contractual relations.

**Illustrations**

1. A rents a full computer network to B and installs it. The contract says nothing as to A’s possible obligation to give B at least some basic information concerning the operation of the system. This may however be considered to be an implied obligation since it is obvious, and necessary for the accomplishment of the purpose of such a contract, that the provider of sophisticated goods should supply the other party with a minimum of information (see Article 5.1.2(a)).
2. A broker who has negotiated a charterparty claims the commission due. Although the brokerage contract is silent as to the time when the commission is due, the usages of the sector can provide an implied term according to which the commission is due, for example, only when the hire is earned, or alternatively when the charterparty was signed, regardless of whether or not the hire will effectively be paid (see Article 5.1.2(b)).
3. A and B, who have entered into the negotiation of a co-operation agreement, conclude an agreement concerning a complex feasibility study, which will be most time-consuming for A. Long before the study is completed, B decides that it will not pursue the negotiation of the co-operation agreement. Even though nothing has been stipulated regarding such a situation, good faith requires B to notify A of its decision without delay (see Article 5.1.2(c)).

**ARTICLE 5.1.3**

*(Co-operation between the parties)*

**Each party shall cooperate with the other party when such co-operation may reasonably be expected for the performance of that party’s obligations.**

**COMMENT**

A contract is not merely a meeting point for conflicting interests but must also, to a certain extent, be viewed as a common project in which each party must cooperate. This view is clearly related to the principle of good faith and fair dealing (see Article 1.7) which permeates the law of contract, as well as to the obligation to mitigate harm in the event of non-performance (see Article 7.4.8).

The duty of co-operation must of course be confined within certain limits (the provision refers to reasonable expectations), so as not to upset the allocation of duties in the performance of the contract. Although the principal concern of the provision is the duty not to hinder the other party's performance, there may also be circumstances which call for more active co-operation.

**Illustrations**

1. A, after contracting with B for the immediate delivery of a certain quantity of oil, buys all the available oil on the spot market from another source. Such conduct, which will hinder B in performing its obligation, is contrary to the duty of co-operation.
2. A, an art gallery in country X, buys a sixteenth century painting from B, a private collector in country Y. The painting may not be exported without a special authorisation and the contract requires B to apply for that permission. B, who has no experience of such formalities, encounters serious difficulties with the application whereas A is familiar with such procedures. In these circumstances, and notwithstanding the contractual provision, A can be expected to give at least some assistance to B.

**ARTICLE 5.1.4**

*(Duty to achieve a specific result.*

*Duty of best efforts)*

**(1) To the extent that an obligation of a party involves a duty to achieve a specific result, that party is bound to achieve that result.**

**(2) To the extent that an obligation of a party involves a duty of best efforts in the performance of an activity, that party is bound to make such efforts as would be made by a reasonable person of the same kind in the same circumstances.**

**COMMENT****1. Distinction between the duty to achieve a specific result and the duty of best efforts**

The degree of diligence required of a party in the performance of an obligation varies considerably depending upon the nature of the obligation incurred. Sometimes a party is bound only by a duty of best efforts. That party must then exert the efforts that a reasonable person of the same kind would exert in the same circumstances, but does not guarantee the achievement of a specific result. In other cases, however, the obligation is more onerous and such a specific result is promised.

The distinction between a “duty to achieve a specific result” and a “duty of best efforts” corresponds to two frequent and typical degrees of severity in the assumption of a contractual obligation, although it does not encompass all possible situations.

Obligations of both types may coexist in the same contract. For instance, a firm that repairs a defective machine may be considered to be under a duty of best efforts concerning the quality of the repair work in general, and under a duty to achieve a specific result as regards the replacement of certain spare parts.

**2. Distinction provides criteria for determining whether a party has performed its obligations**

Taken together, the two paragraphs of this Article provide judges and arbitrators with criteria by which correct performance can be evaluated. In the case of an obligation to achieve a specific result, a party is bound simply to achieve the promised result, failure to achieve which amounts in itself to non-performance, subject to the application of the force majeure provision (see Article 7.1.7). On the other hand, the assessment of non-performance of an obligation of best efforts calls for a less severe judgment, based on a comparison with the efforts a reasonable person of the same kind would have made in similar circumstances. This distinction signifies that more will be expected from a highly specialised firm selected for its expertise than from a less sophisticated partner.

**Illustrations**

1. A, a distributor, promises that it will reach a quota of 15,000 sales within a year in the contract zone. If at the end of the period A has sold only 13,000 items, it has clearly failed to perform its obligation (see Article 5.1.4(1)).

2. B, another distributor, promises “to use our best efforts to expand the sales of the product” in the contract zone, without any stipulation that it must reach a minimum quantity. This provision creates an obligation of best efforts; it obliges B to take all the steps that a reasonable person, placed in similar circumstances (nature of the product, characteristics of the market, importance and experience of the firm, presence of competitors, etc.) would take to promote the sales (advertising, visits to customers, proper service, etc.). B does not promise the specific result of selling a certain number of items per year, but does undertake to do all that can be expected of it when acting as a reasonable person (see Article 5.1.4(2)).

### **ARTICLE 5.1.5**

*(Determination of kind of duty involved)*

**In determining the extent to which an obligation of a party involves a duty of best efforts in the performance of an activity or a duty to achieve a specific result, regard shall be had, among other factors, to**

**(a) the way in which the obligation is expressed in the contract;**

**(b) the contractual price and other terms of the contract;**

**(c) the degree of risk normally involved in achieving the expected result;**

**(d) the ability of the other party to influence the performance of the obligation.**

### **COMMENT**

#### **1. Criteria for determining the nature of the obligation**

It is important to determine whether an obligation involves a duty to achieve a specific result or simply a duty of best efforts, as the obligation is more onerous in the former case. Such a determination may sometimes be difficult. This Article therefore establishes criteria which may offer guidance to parties, judges and arbitrators, although the list is not exhaustive. The problems involved are frequently matters of interpretation.

## **2. Nature of the obligation as expressed by the contract**

The way in which an obligation is expressed in the contract may often be of assistance in determining whether the parties intended to create a duty to achieve a specific result or a duty of best efforts.

### **Illustration**

1. A, a contractor, agrees to build storage facilities for B, who is most keen that the work be finished in an unusually short time. If A undertakes that “the work will be completed before 31 December”, it assumes an obligation to achieve the specific result of meeting that deadline. If it merely undertakes “to try to complete the work before 31 December”, its obligation involves a duty of best efforts to attempt to meet the deadline, but no guarantee that it will definitely be met (see Article 5.1.5(a)).

## **3. Price or other terms of the contract**

The contractual price or other terms of the contract may also offer clues as to the nature of an obligation. An unusually high price or another particular non-monetary reciprocal obligation may indicate a duty to achieve a specific result in cases where a mere duty of best efforts would normally be assumed. Clauses linking payment of the price to the successful outcome of the operation, penalty clauses applicable if the result is not achieved and hardship clauses enabling a party to adapt the contract if circumstances make it too harsh to perform as initially agreed are other examples of contractual terms which may - in one way or another - assist in determining the nature of the obligation in question (see Article 5.1.5(b)).

## **4. Degree of risk in performance of an obligation**

When a party's performance of an obligation normally involves a high degree of risk it is generally to be expected that that party does not intend to guarantee a result, and that the other party does not expect such a guarantee. The opposite conclusion will be drawn when the desired result can as a rule be achieved without any special difficulty (see Article 5.1.5(c)).

**Illustrations**

2. A space agency undertakes to put a telecommunication satellite into orbit, the rate of failure of past launchings having been 22%. The space agency cannot be expected to guarantee that the orbiting will be successful. The obligation is merely to observe the degree of diligence required for such launchings in view of the present state of technology.
3. A promises to deliver 20 tons of steel to B on 30 June. Such a relatively simple operation is subject to no special risk. A is committed to the specific result of delivering the required quantity of steel on the date specified and not merely to attempting to do so.

**5. Influence of obligee over performance of an obligation**

In some situations one party may have a degree of influence over the performance of the other party's obligations. This fact may transform into duties of best efforts obligations which might otherwise be characterised as duties to achieve specific results.

**Illustration**

4. A is prepared to provide B with the technical assistance necessary to apply a newly discovered chemical process, and it is agreed that B will send some of its engineers to attend training sessions organised by A. A cannot promise that the new process will be mastered by the other party, since that result depends in part on B's effectively sending its engineers to the training sessions, on those engineers' competence and on their attentiveness at the sessions (see Article 5.1.5(d)).

**ARTICLE 5.1.6**

*(Determination of quality of performance)*

**Where the quality of performance is neither fixed by, nor determinable from, the contract a party is bound to render a performance of a quality that is reasonable and not less than average in the circumstances.**

**COMMENT**

Standards have been set in Article 5.1.4 concerning the exercise of “best efforts”, but quality of performance is a wider problem addressed by Article 5.1.6. If goods are to be supplied, or services rendered, it is not sufficient to supply those goods or to render those services; they must also be of a certain quality.

The contract will often be explicit as regards the quality due (“grade 1 oil”), or it will provide elements making that quality determinable. In other cases, the rule established by Article 5.1.6 is that the quality must be “reasonable and not less than average in the circumstances”. Two criteria are thus combined.

**Illustration**

1. A undertakes to build a hotel next to a busy railway station. The contract provides for “adequate sound isolation”, the quality of which is not more precisely determined. It is, however, determinable from the contract that the sound isolation must meet the high standards needed in view of the hotel’s proximity to a railway station.

**1. Performance must be of average quality**

The minimum requirement is that of providing goods of average quality. The supplier is not bound to provide goods or services of superior quality if that is not required by the contract, but neither may it deliver goods or services of inferior quality. This average quality is determined according to the circumstances, which normally means that which is available on the relevant market at the time of performance (there may for example have been a recent technological advance). Other factors may also be of relevance, such as the specific qualifications for which the performing party was chosen.

**Illustration**

2. A buys 500 kgs. of oranges from B. If the contract says nothing more precise, and no other circumstances call for a different solution, those oranges may not be of less than average quality. Average quality will however suffice unless it is unreasonably defective.

**2. Performance must be reasonable**

The additional reference to reasonableness is intended to prevent a party from claiming that it has performed adequately if it has rendered an “average” performance in a market where the average quality is most unsatisfactory and is intended to give the judge or arbitrator an opportunity to raise those insufficient standards.

**Illustration**

3. A company based in country X organises a banquet to celebrate its 50<sup>th</sup> anniversary. Since the cuisine in country X is mediocre, the company orders the meal from a renowned restaurant in Paris. In these circumstances the quality of the food provided must not be less than the average standards of the Parisian restaurant. It would clearly not be sufficient simply to meet the average standards of country X.

**ARTICLE 5.1.7***(Price determination)*

**(1) Where a contract does not fix or make provision for determining the price, the parties are considered, in the absence of any indication to the contrary, to have made reference to the price generally charged at the time of the conclusion of the contract for such performance in comparable circumstances in the trade concerned or, if no such price is available, to a reasonable price.**

**(2) Where the price is to be determined by one party and that determination is manifestly unreasonable, a reasonable price shall be substituted notwithstanding any contract term to the contrary.**

**(3) Where the price is to be fixed by a third person, and that person cannot or will not do so, the price shall be a reasonable price.**

**(4) Where the price is to be fixed by reference to factors which do not exist or have ceased to exist or to be accessible, the nearest equivalent factor shall be treated as a substitute.**



**COMMENT****1. General rule governing price determination**

A contract usually fixes the price to be paid, or makes provision for its determination. If however this is not the case, paragraph (1) of this Article presumes that the parties have made reference to the price generally charged at the time of the conclusion of the contract for such performance in comparable circumstances in the trade concerned. All these qualifications are of course significant. The provision also permits the rebuttal of the presumption if there is any indication to the contrary.

This Article is inspired by Article 55 CISG. The rule has the necessary flexibility to meet the needs of international trade.

It is true that in some cases the price usually charged on the market may not satisfy the reasonableness test which prevails elsewhere in this Article. Recourse would then have to be made to the general provision on good faith and fair dealing (see Article 1.7), or possibly to some of the provisions on mistake, fraud and gross disparity (see Chapter 3, Section 2).

Some international contracts relate to operations which are unique or at least very specific, in respect of which it is not possible to refer to the price charged for similar performance in comparable circumstances. According to paragraph (1) the parties are then deemed to have made reference to a reasonable price and the party in question will fix the price at a reasonable level, subject to the possible review by courts or arbitral tribunals.

**Illustrations**

1. A, a firm specialised in express mailing throughout the world, receives from B a parcel to be delivered as soon as possible from country X to country Y. Nothing is said as to the price. A should bill B with the price usually charged in the sector for such a service.
2. The next order which A receives from B is one to deliver another parcel as soon as possible to remote and not easily accessible country Z, where a team of explorers is in need of urgent supplies. Again, nothing is said as to price, but since no possible market comparison can be made A must act reasonably when fixing the price.

**2. Determination of price by one party**

In some cases the contract expressly provides that the price will be determined by one of the parties. This happens frequently in several sectors, for example the supply of services. The price cannot easily be

determined in advance, and the performing party is in the best position to place a value on what it has done.

In those cases where the parties have made such a provision for determining the price, it will be enforced. To avoid possible abuses however, paragraph (2) enables judges or arbitrators to replace a manifestly unreasonable price by a reasonable one. This provision is mandatory.

### **3. Determination of price by third person**

A provision that the price will be determined by a third person can give rise to serious difficulty if that third person is unable to accomplish the mission (not being the expert he or she was thought to be) or refuses to do so. Paragraph (3) provides that the price, possibly determined by judges or arbitrators, shall be reasonable. If the third person determines the price in circumstances that may involve fraud, gross disparity or threat, Article 3.2.8(2) may apply.

### **4. Determination of price by reference to external factors**

In some situations the price is to be fixed by reference to external factors, typically a published index, or quotations on a commodity exchange. In cases where the reference factor ceases to exist or to be accessible, paragraph (4) provides that the nearest equivalent factor shall be treated as a substitute.

#### **Illustration**

3. The price of a construction contract is linked to several indexes, including the “official index of charges in the construction sector”, regularly published by the local Government. Several instalments of the price still have to be calculated when that index ceases to be published. The Construction Federation, a private trade association, decides however to start publishing a similar index to replace the former one and in these circumstances the new index will serve as a substitute.

**ARTICLE 5.1.8***(Contract for an indefinite period)*

**A contract for an indefinite period may be ended by either party by giving notice a reasonable time in advance.**

**COMMENT**

The duration of a contract is often specified by an express provision, or it may be determined from the nature and purpose of the contract (e.g. technical expertise provided in order to assist in performing specialised work). However, there are cases when the duration is neither determined nor determinable. Parties can also stipulate that their contract is concluded for an indefinite period.

This Article provides that in such cases either party may end the contractual relationship by giving notice a reasonable time in advance. What a reasonable time in advance will be will depend on circumstances such as the period of time the parties have been cooperating, the importance of their relative investments in the relationship, the time needed to find new partners, etc.

The rule can be understood as a gap-filling provision in cases where parties have failed to specify the duration of their contract. More generally, it also relates to the widely recognised principle that contracts may not bind the parties eternally and that they may always opt out of such contracts provided they give notice a reasonable time in advance.

This situation is to be distinguished from the case of hardship which is covered by Articles 6.2.1 to 6.2.3. Hardship requires a fundamental change of the equilibrium of the contract, and gives rise, at least in the first instance, to renegotiations. The rule in this Article requires no special condition to be met, except that the duration of the contract be indefinite and that it permit unilateral cancellation.

**Illustration**

A agrees to distribute B's products in country X. The contract is concluded for an indefinite period. Either party may cancel this arrangement unilaterally, provided that it gives the other party notice a reasonable time in advance.

**ARTICLE 5.1.9***(Release by agreement)*

**(1) An obligee may release its right by agreement with the obligor.**

**(2) An offer to release a right gratuitously shall be deemed accepted if the obligor does not reject the offer without delay after having become aware of it.**

**COMMENT**

An obligee may wish to release the obligor from its obligation (or, in case the obligor owes more than one obligation, from more than one or from all its obligations). The release may either be a separate act, or constitute a part of a more complex transaction between the parties, e.g. a compromise which settles a dispute between them.

This Article provides that such renunciation of the obligee's right(s) requires an agreement between the parties, irrespective of whether the obligee renounces its right(s) for value or gratuitously.

In the latter case, while the obligor should not be compelled to accept a benefit against its will, it will normally consent to accepting the benefit. For this reason paragraph (2) provides that a gratuitous offer shall be deemed accepted if the obligor does not reject the offer without delay after having become aware of it.

**Illustrations**

1. Company A is in financial difficulties and needs the co-operation of its creditors in order to survive. Bank B is prepared to renounce 50% of its claim against A and the interest that has fallen due on condition that A pay an interest of 9% (instead of the 5% paid previously) on the remaining debt. B sends a notice to this effect on 15 January. By 22 January A has not reacted to the notice. B's renunciation will only be effective after A has accepted B's offer in accordance with Article 2.1.6 *et seq.*

2. Company A is in financial difficulties and needs the co-operation of its creditors in order to survive. Bank B is prepared to renounce 50% of its claim against A and the interest that has fallen due and sends A a notice to this effect on 15 January. By 22 January A has not reacted to the notice. B's offer is deemed to be accepted by A.

## SECTION 2: THIRD PARTY RIGHTS

### ARTICLE 5.2.1

*(Contracts in favour of third parties)*

**(1) The parties (the “promisor” and the “promisee”) may confer by express or implied agreement a right on a third party (the “beneficiary”).**

**(2) The existence and content of the beneficiary’s right against the promisor are determined by the agreement of the parties and are subject to any conditions or other limitations under the agreement.**

### COMMENT

Usually contracts are intended by the parties to create rights and obligations between themselves. In such cases only the parties will acquire rights and duties under the contract. The mere fact that a third party will benefit from the performance of the contract does not in itself give that third party any rights under the contract.

### Illustration

1. Professor A makes a contract with the University of country X under which he agrees to give forty one-hour lectures comparing the laws of contract of countries X and Y. A only appears for twenty lectures and does not mention the law of country Y in the lectures. T, a student, does not acquire rights under the contract between A and the University.

However, third parties are not always left without rights. The underlying principle is that of the autonomy of the parties, who, if they wish to create rights in a third party, should be free to do so. The parties may state expressly that this is their intention, but this is not essential since the intention to benefit the third party may be implicit in the contract. In cases where implied intention is alleged, the decision will turn on all the terms of the contract and the circumstances of the case.

The following are illustrations of implied intention.

**Illustrations**

2. A takes out a policy of insurance on its fleet of lorries which are regularly driven by its employees. The contract provides that the insurance company will cover anyone driving a lorry with A's consent. An employee, T, has an accident while driving the lorry. T is covered in respect of its liability for the accident.

3. A sells his business to B on the terms that B will pay A GBP 1,000 a month for the rest of his life and will pay A's wife, T, GBP 500 a month if A predeceases her. A dies. B refuses to pay T anything. T is entitled to the GBP 500 a month.

4. A, the International World University, wishes to build a new law library on land owned by the University. For legitimate tax reasons the contract for the erection of the library is made by B, a company wholly owned by the University, although the contractor well knows that when completed the library will be occupied and used by A. The building has been badly built and it will cost USD 5,000,000 to complete it satisfactorily. A can recover the cost of the remedial work.

5. A, the developer of a shopping mall, concludes a contract with B, a security firm, to provide security at the mall. Both A and B know that the shops will be operated by tenants of A. These tenants are told that one of the major attractions of the mall will be the high level of security provided by B. It is a term of the contract between A and B that all employees of B working at the mall will be expolicemen personally selected by B's chief executive. In fact, selection is delegated to a consultancy firm which recruits many unsuitable people. There are many thefts at the shops. Tenants who suffer losses will have contractual claims against B.

The following are illustrations where there is no such implied intention unless the circumstances clearly indicate otherwise.

**Illustrations**

6. A goes to an expensive furrier and selects and buys a coat. A tells the assistant (truthfully) that it is for T, the wife of a visiting head of State. By the side of the coat is a prominent card saying "It looks like mink, it feels like mink but is guaranteed man made." A gives the coat to T. In fact, owing to a mistake by the furrier, the coat is a real mink coat and T is subjected to violent and hostile criticism by animal lovers in her country. T has no enforceable contract right.

7. A, a company with a large factory, concludes a contract with a company operating the local sewage system. Under the contract, A is entitled to discharge its waste into the sewer but undertakes not to discharge certain types of waste. In breach of this undertaking, A discharges waste which blocks the sewer and causes damage to T, another user of the sewer. T has no enforceable contract right.

8. A, a company from country X, sells materials to B, a company from country Y. A knows that B plans to resell the materials to T, a pharmaceutical company from country Z, which will use the materials for the manufacture of a new drug under a contract which will effectively limit B's liability to T to USD 1,000,000. The materials are defective and T's losses greatly exceed USD 1,000,000. T has no enforceable contract right against A.

The application of this Article will often come up in the context of an associated claim in tort. This possibility is outside the scope of the Principles.

It follows from the scheme of this Article that an express statement that the parties do not intend to create rights in a third party will be effective. It also follows that the promisor and promisee enjoy broad powers to shape the rights created in favour of the beneficiary. In this context the word "rights" should be interpreted liberally. In principle, a third party beneficiary will have the full range of contractual remedies including the right to performance and damages.

#### ARTICLE 5.2.2

*(Third party identifiable)*

**The beneficiary must be identifiable with adequate certainty by the contract but need not be in existence at the time the contract is made.**

#### COMMENT

The parties may well wish to make a contract in which the identity of the third party is not known at the time the contract is made, but a mechanism is provided by which it will become known by the time performance is due. This might be by providing that the parties, or one of them, can identify the beneficiary at a later date, or by choosing a definition of the beneficiary, of which later circumstances will serve to make the identity clear.

## Illustrations

1. A, a married man with children but no grandchildren, makes a contract with the XYZ insurance company under which A pays GBP 10 a month to the insurance company and they promise to pay GBP 10,000 to each of his grandchildren on his death. Grandchildren born after the date of the contract but before A's death are entitled to GBP 10,000.
2. Company A launches a takeover bid for company B, a public company the shares of which are traded on leading stock exchanges. B engages C, a leading firm of accountants, to prepare a report on B for distribution to shareholders. The contract between B and C requires C to produce an honest, thorough and competent report. Owing to incompetence C produces a report that is much too favourable to B. As a result the majority of shareholders vote to reject A's offer. Some shareholders show copies of the report to friends who buy shares in B. The old shareholders can acquire rights under the contract between B and C but the new shareholders cannot.

**ARTICLE 5.2.3**

*(Exclusion and limitation clauses)*

**The conferment of rights in the beneficiary includes the right to invoke a clause in the contract which excludes or limits the liability of the beneficiary.**

**COMMENT**

Contractual provisions limiting or excluding liability of those who are not parties to the contract are very common, particularly in contracts of carriage, where they often form part of a settled pattern of insurance. Perhaps the best known example is the so-called Himalaya clause, which in some form is frequently to be found in bills of lading. In general the autonomy of the parties should be respected in this area too.

## Illustration

A, the owner of goods, makes a contract with a sea carrier to carry them from country X to country Y. The bill of lading is subject to the Hague-Visby Rules and purports to exclude the liability of (a) the master and crew; (b) stevedores employed in loading and unloading the cargo; and (c) the owners of ships onto which the goods may be transhipped. These exclusions will be effective.



Another situation which would be covered by this Article arises where the promisor and promisee agree that the beneficiary shall be released from an obligation which it owed the promisor.

#### ARTICLE 5.2.4

*(Defences)*

**The promisor may assert against the beneficiary all defences which the promisor could assert against the promisee.**

#### COMMENT

Under Article 5.2.1 the content of the beneficiary's right may be made subject to any conditions or limitations devised by the parties. The promisor and promisee may devise a contract in which the position of the beneficiary is significantly different from that of the promisee. The parties' autonomy is in principle unlimited but they may well not provide expressly for all possibilities. The normal default rule will therefore be as stated in this Article.

#### Illustrations

1. A takes out a policy of life insurance with insurance company B in favour of C. The contract provides for the payment of premiums for 25 years but after 5 years A stops paying premiums. The position of C will be modelled on that of A if the policy had been in A's favour. Such policies do not usually deny all return on the premiums paid. If, however, the policy had been liable to be set aside by the insurance company, for instance because A had not made material disclosure, then B would normally be entitled to raise this defence against C.
2. Company A takes out a policy of fidelity insurance with insurance company B to cover dishonest employees. The insurance policy provides that B will indemnify in full customers who are defrauded by employees of A and that it will indemnify A only if A has not been negligent in the selection or supervision of the employees. Clearly in such a contract B will have defences against A which it cannot raise against the customers.

**ARTICLE 5.2.5**  
*(Revocation)*

**The parties may modify or revoke the rights conferred by the contract on the beneficiary until the beneficiary has accepted them or reasonably acted in reliance on them.**

**COMMENT**

It might be the rule that the promisor and promisee are free to revoke the third party's rights at any time or, contrariwise, that the third party's rights are immutable once the contract is concluded. It appears that few systems adopt either of these extreme positions. The solution adopted is that the third party's rights become irrevocable once the third party has either accepted the rights or has reasonably acted in reliance on them. It will, of course, be open to the parties to provide for a different regime in the contract either by making the beneficiary's rights irrevocable sooner, or by preserving a right of revocation even after the beneficiary has acted in reliance on the rights. There may well be situations where a right of revocation is given only to one party. For example, in a contract of life insurance it might be provided that the insured can change the beneficiary. There might be relevant usages which limit the possibility of revocation.

**Illustration**

A, the main contractor on a major construction contract, takes out a policy of insurance with insurance company B to cover damage to the work in progress. The policy is expressed to cover the interests of all sub-contractors involved in the contract and the sub-contractors are all told of the policy. C, a sub-contractor, does not take out any insurance itself, but does not tell A or B. Absent clear words to the contrary, C's reliance makes the contract between A and B irrevocable.

**ARTICLE 5.2.6**  
*(Renunciation)*

**The beneficiary may renounce a right conferred on it.**

**COMMENT**

The scheme of this Section assumes that, absent contrary provision, the contract between promisor and promisee creates rights in the beneficiary at once, without any need for acceptance by the beneficiary.

Although the third party will usually welcome the benefit which the parties have conferred upon it, it cannot be forced to accept it. It follows that the third party may expressly or impliedly renounce the benefit.

However, once the beneficiary has done something that amounts to acceptance, it should not normally be entitled to renounce.

**Illustration**

On the facts given in the Illustration to Article 5.2.5, C, a sub-contractor, may not wish to take advantage of the insurance taken out by the main contractor because it already has relevant insurance in place (and it knows that there will be difficulties if there are two insurances covering the same risk). C is entitled to renounce.

## SECTION 3: CONDITIONS

### ARTICLE 5.3.1 *(Types of condition)*

**A contract or a contractual obligation may be made conditional upon the occurrence of a future uncertain event, so that the contract or the contractual obligation only takes effect if the event occurs (suspensive condition) or comes to an end if the event occurs (resolutive condition).**

#### COMMENT

##### 1. Scope of this Section

Parties to a contract may make their contract or one or several obligations arising under it dependent on the occurrence or non-occurrence of a future uncertain event. A provision to this effect is called a condition.

Conditions governed by the Principles include both those that determine whether a contract exists and those that determine obligations within a contract. Accordingly, application of the Principles may in some circumstances impose duties even in the absence of a contract (see, e.g., Articles 5.3.3 and 5.3.4).

A condition may refer to a range of events, including natural events or acts of a third person.

This Section only deals with conditions that originate in an agreement between the parties.

Conditions imposed by law are not covered by this Section unless they are incorporated into the contract by the parties. Thus, a public permission requirement imposed by law is outside the scope of this Section but may be governed by Article 6.1.14. However, if the parties introduce a provision making the contract, or their contractual obligations arising under it, dependent upon a public permission being granted, then that provision is a condition.

## 2. Notion of condition

The word “condition” may have a number of meanings. For instance, in some jurisdictions condition means a major term of the contract. That is not the sense in which the term “condition” is used in this Section.

Some contracts may provide that the performance by one party is dependent upon the performance of the other party. These provisions are not conditions, they merely specify the obligations of both parties under their contract.

### Illustration

1. In a share purchase and sale agreement concluded between seller A incorporated in country X, and purchaser B incorporated in country Y, B’s obligation to pay the agreed price is subject to A’s having “performed all of its obligations hereunder to be performed on or before a certain date”. This performance is not a condition, but a contractual obligation and as such is not an uncertain event.

The parties may also fix a specific date at which the contract, or one or several of the obligations arising under it, is to take effect or is to come to an end. In many jurisdictions these provisions are referred to as “terms”. They are not conditions under this Section. The same holds true when the parties include a provision in their contract that makes the contract or one or several of the obligations arising under the contract dependent upon the occurrence of a future event that is bound to happen.

### Illustrations

2. A contract of sale is concluded on 2 October, with the delivery of the goods to be made on 10 October. The obligation to deliver is not conditional because it is not subject to a future uncertain event.
3. Architect A, who intends to renovate her offices, borrows money from a bank and the loan agreement provides that title to a particular property A owns will pass to the bank on A’s death. This is not a condition since A’s death is certain to occur.

The parties may in their contract provide for a time by which the condition has to occur.

**Illustration**

4. A share purchase agreement is concluded between A and B. It will take effect if all necessary authorisations are received by 30 January. The agreement is conditional and it includes a date by which the condition has to occur if the parties' obligations are to come into effect.

If the contract does not state a specific time by which the condition must occur, in appropriate circumstances the time may be implied on the basis of an interpretation of the intentions of the parties under Chapter 4.

**3. Suspensive and resolutive conditions**

A contract or contractual obligation can be made to depend upon the occurrence of a future uncertain event, so that it takes effect only if the event occurs. Under the Principles this is a suspensive condition. In some jurisdictions it is known as "condition precedent".

**Illustration**

5. A merger contract is concluded between A and B subject to A's having received the necessary antitrust clearance for the transaction from the relevant authorities before a specific date.

A contract or a contractual obligation can be made to come to an end upon the occurrence of a future uncertain event. Under the Principles this is a resolutive condition. In some jurisdictions it is known as "condition subsequent".

**Illustration**

6. A contract appointing B as a fund manager to manage the investments of a company provides that the agreement is to come to an end if B loses its licence to conduct the fund management business.

Instead of agreeing on a resolutive condition, the parties to a contract may agree that one or both of them may, under certain circumstances, have the right to terminate the contract.

**4. Condition entirely dependent on the will of the obligor**

Sometimes the contract or contractual obligation is made dependent upon an event which is entirely in the discretion of the obligor. In this case the question is of whether the obligor really wants to be bound. This is a question of interpretation. If it appears that there is no intention to be bound, there is no contract, nor is there any contractual obligation.

### Illustration

7. A document drawn up between A and B contains a list of provisions. One of them states that a contract of sale will come into being if A decides to sell certain goods. A is under no obligation, not even a conditional one, in view of the fact that it is within A's unfettered discretion to decide whether or not A wants to sell the goods. The fact that A may be under a pre-contractual obligation not to act in bad faith is irrelevant in this case.

In some cases there is a conditional obligation in spite of the fact that one party has a choice whether or not to conclude the contract. This holds true when the freedom of choice is in actual fact dependent upon external factors.

### Illustration

8. An international merger agreement provides for the merger within a certain period of time of two subsidiaries of a parent company, subject to approval by the Board of Directors of one of the companies. Under the applicable law the approval cannot be unreasonably withheld. There is a conditional obligation since the condition is not entirely dependent on the will of one of the parties.

## 5. Closing

Parties to complex and high-value business transactions that involve prolonged negotiations frequently provide for a so-called "closing" procedure, i.e. the formal acknowledgement ("closing") at a certain point in time ("closing date") that on or before that date all the stipulated conditions ("conditions precedent") have been satisfied. Normally, but not necessarily, on the "closing date" the parties will sign a document which confirms that no "condition precedent" survives or, if some conditions have not been satisfied, that they have been waived.

Despite the terminology used by the parties, not all the events referred to as "conditions precedent" are "conditions" as defined by this Article. In actual practice, there are mixed provisions. Thus, for instance, events such as the receipt of all necessary antitrust clearances, the admittance to trading on a stock exchange, the granting of an export licence, and the obtaining of a bank loan, may be true suspensive conditions because they are events that are not certain to occur. Other terms such as the accuracy of one party's representations or warranties, the commitment to perform or abstain from some specific acts, and the submission of a tax certificate that evidences that no taxes are due by the party concerned, are in fact obligations that the parties have agreed to fulfil before the formal conclusion ("completion") of the transaction.

These are not events that are uncertain to occur and, therefore, these provisions are not conditions under the Principles.

Also, with respect to the effects of a “closing”, there is no clear-cut rule as to whether or not a term is a condition. In practice it is difficult to derive a logical answer from the clauses themselves. In particular, clauses named “conditions precedent” often mix up real conditions and specific matters that still need to be agreed upon or real obligations that the parties must fulfil in the course of the negotiations (see Article 2.1.13).

### Illustration

9. A Share Capital Increase Agreement negotiated between issuer A and lead manager B under the heading “Conditions precedent” provides as follows:

“The obligation of the Lead Manager at the closing date to subscribe for the shares is subject to the realisation of the following conditions precedent on or prior to the closing date:

- a. Accuracy of representations and warranties;
- b. Performance of undertakings: the Issuer has performed all of those of its obligations hereunder to be performed on or before the closing date;
- c. Admittance to trading on stock exchange;
- d. Delivery of any and all closing documents: the Lead Manager shall have received the following documents on or before the closing date [...].

If any one of the above conditions has not been satisfied at the time it should have been satisfied pursuant to this Section, the obligations of the Lead Manager may be terminated by the Lead Manager.”

In this Illustration, the contract consists of a mixture of legal obligations and suspensive conditions: item (c) is a suspensive condition, as it is outside the control of the parties; items (a) and (b) embody contractual obligations; and item (d) embodies a contractual obligation as regards the documents a party is under an obligation to procure but a suspensive condition as regards other documents.



**ARTICLE 5.3.2**  
*(Effect of conditions)*

**Unless the parties otherwise agree :**

**(a) the relevant contract or contractual obligation takes effect upon fulfilment of a suspensive condition;**

**(b) the relevant contract or contractual obligation comes to an end upon fulfilment of a resolutive condition.**

**COMMENT**

**1. A general default rule**

Under the Principles, unless the parties otherwise agree, the fulfilment of a condition has prospective effect only. It does not operate retroactively.

Parties are encouraged to express whether a condition operates retroactively or prospectively.

**2. No retroactive effect**

In the case of a suspensive condition, the contract or contractual obligation automatically becomes effective from the moment the future uncertain event occurs.

**Illustration**

1. The facts are the same as in Illustration 5 to Article 5.3.1. The contract takes effect if and when the necessary antitrust clearance is obtained.

In the case of a resolutive condition, the contract or contractual obligation comes to an end from the moment the future uncertain event occurs.

**Illustration**

2. The facts are the same as in Illustration 6 to Article 5.3.1. The contract comes to an end if and when B loses its licence.

**ARTICLE 5.3.3***(Interference with conditions)*

**(1) If fulfilment of a condition is prevented by a party, contrary to the duty of good faith and fair dealing or the duty of co-operation, that party may not rely on the non-fulfilment of the condition.**

**(2) If fulfilment of a condition is brought about by a party, contrary to the duty of good faith and fair dealing or the duty of co-operation, that party may not rely on the fulfilment of the condition.**

**COMMENT**

This Article on interference with conditions is a specific application of the general rules on good faith and fair dealing (see Article 1.7), inconsistent behaviour (see Article 1.8) and co-operation between the parties (see Article 5.1.3).

Under this Article, the party is not under an obligation to use all reasonable efforts to bring about the fulfilment of the condition. This Article merely states that the party who, contrary to the duties of good faith and fair dealing or co-operation, prevents the condition from being fulfilled may not rely on the non-fulfilment of the condition. If, on the contrary, the party brings about the fulfilment of a condition contrary to the duties of good faith and fair dealing or co-operation, that party may not rely on the fulfilment of the condition.

Whether or not a party is under an obligation to use all reasonable efforts to bring about the fulfilment of a condition is a matter of interpretation. In commercial practice, the parties themselves may expressly provide for the observance of the principle of good faith as regards all the events upon which completion of the transaction is conditional or go beyond this minimum standard and impose a duty to use “their best efforts to bring about the fulfilment of the conditions as soon as practicable”. These clauses may also be imposed on one party only (see Article 5.1.4).

The available remedies (right to performance or damages) are to be determined in accordance with the contractual provisions and the general rules on these remedies, as well as with the particular circumstances of the case.

Four factual situations can be distinguished to illustrate the operation of this Article.

(a) Where the fulfilment of a suspensive condition is prevented by a party contrary to the duty of good faith and fair dealing or the duty of cooperation, that party may not rely on the non-fulfilment of the condition.

#### Illustration

1. The licensing of software by B to A is agreed by the parties to be dependent upon the professional approval of the software by an independent computer engineer, C, who is nominated by B. B regrets the bargain and bribes C not to approve the software. Because of the bribe, C states that it does not approve the software. B is not allowed to rely on the non-fulfilment of the condition, i.e. B cannot refuse to perform the obligation under the contract when asked by A to do so.

(b) Where the fulfilment of a resolutive condition is prevented by a party contrary to the duty of good faith and fair dealing or the duty of cooperation, that party may not rely on the non-fulfilment of the condition.

#### Illustration

2. A hires earth-moving equipment from B for the time necessary for A to purchase its own equipment. As a commercial favour to A, the rate of hire is below the market rate. B's obligation to make the earth-moving equipment available is subject to the resolutive condition that it comes to an end if A acquires its own earth-moving equipment. A turns down very attractive offers in order to continue benefiting from the favourable rate of hire. A may not rely on the non-fulfilment of the condition.

(c) Where the fulfilment of a suspensive condition is brought about by a party contrary to the duty of good faith and fair dealing or the duty of cooperation, that party may not rely on the fulfilment of the condition.

#### Illustration

3. The facts are the same as in Illustration 1, except that B bribes C to give its approval of the software despite C's professional misgivings about the software. B is not allowed to rely on the fulfilment of the condition, i.e. B cannot ask A to perform the contract.

(d) Where the fulfilment of a resolutive condition is brought about by a party contrary to the duty of good faith and fair dealing or the duty of cooperation, that party may not rely on the fulfilment of the condition.

#### Illustration

4. A appoints B as its agent for the promotion and sale of A's products. The agreement is to come to an end if the gross amount of sales made by B fails to reach EUR 1,000,000 by 31 December the second year. A, who has found another party willing to act as agent on terms more favourable to A than B, withholds supplies to B with the result that by the above date B's gross sales fall well short of EUR 1,000,000. A may not rely on this to treat the agreement with B as having come to an end.

#### **ARTICLE 5.3.4**

*(Duty to preserve rights)*

**Pending fulfilment of a condition, a party may not, contrary to the duty to act in accordance with good faith and fair dealing, act so as to prejudice the other party's rights in case of fulfilment of the condition.**

#### **COMMENT**

This Article only relates to the acts performed during the period that precedes the time when the condition is fulfilled. It does not concern acts which amount to an interference with conditions. These acts are dealt with by Article 5.3.3.

The situation in which fulfilment of the condition is pending is specific and deserves special treatment in application of the general principle of good faith and fair dealing (see Article 1.7). Indeed, a person who would benefit from the fulfilment of a condition has a conditional right which deserves protection (particularly in the case of a suspensive condition). During the period pending fulfilment of the condition one party's actions may detrimentally affect the other party's position. This Article assumes that it is generally better to prevent such actions than to cure their effects.

This Article is also important as a reminder to the parties to consider this issue and even state expressly what measures the person who would benefit from the fulfilment of the condition might take in order to preserve its rights. In commercial practice parties may draft a specific provision (sometimes known as “covenant of ordinary course of business”) that produces effects between the date of signature and the “closing date” and restricts the parties’ right to dispose of assets only to those transactions that fall within the ordinary course of business.

#### Illustration

A share purchase agreement entered into between the seller A and the purchaser B provides that the transaction will be completed only if, at the closing date, all the conditions have been met, including B’s having obtained the necessary credit from its banks. A is bound to restrict its activity to ordinary business management and B is under a duty of confidentiality as to any information concerning the company that it has received in the course of negotiations.

#### ARTICLE 5.3.5

*(Restitution in case of fulfilment of a  
resolutive condition)*

**(1) On fulfilment of a resolutive condition, the rules on restitution set out in Articles 7.3.6 and 7.3.7 apply with appropriate adaptations.**

**(2) If the parties have agreed that the resolutive condition is to operate retroactively, the rules on restitution set out in Article 3.2.15 apply with appropriate adaptations.**

#### COMMENT

When a contract subject to a resolutive condition comes to an end as a result of the fulfilment of the resolutive condition, the parties will often have performed, fully or in part, their obligations under the contract. The question then arises whether and, if so, under which rules, the parties have to make restitution of what they have received.

Under the Principles, the fulfilment of a resolutive condition normally has prospective effects only. For this reason restitution will

have to follow the regime set out in Articles 7.3.6 and 7.3.7 on restitution following the termination of a contract, which also operates only prospectively. The specificity of this restitution regime vis-à-vis the restitution regime set out in Article 3.2.15 is that for contracts to be performed over a period of time, restitution cannot be claimed for the period prior to the moment when the contract came to an end.

However, under the Principles parties are free to determine that a resolutive condition is to operate retroactively. Under these circumstances it appears to be appropriate to apply the restitution regime set out in Article 3.2.15 (restitution following avoidance), since avoidance also operates retroactively. There is no special rule for restitution in the case of contracts performed over a period of time.

## CHAPTER 6

### PERFORMANCE

#### SECTION 1: PERFORMANCE IN GENERAL

##### ARTICLE 6.1.1

*(Time of performance)*

**A party must perform its obligations:**

**(a) if a time is fixed by or determinable from the contract, at that time;**

**(b) if a period of time is fixed by or determinable from the contract, at any time within that period unless circumstances indicate that the other party is to choose a time;**

**(c) in any other case, within a reasonable time after the conclusion of the contract.**

##### COMMENT

With a view to determining when a contractual obligation is to be performed, this Article, which is inspired by Article 33 CISG, distinguishes three situations. The first is where the contract stipulates the precise time for performance or makes it determinable. If the contract does not specify a precise moment but a period of time for performing, any time during that period chosen by the performing party will be acceptable unless circumstances indicate that the other party is to choose the time. Finally, in all other cases, performance is due within a reasonable time.

##### Illustrations

1. A offers to advise B in the latter's plans to buy computer equipment and software and it is agreed that A's experts will visit B "in May". It is in principle for A to announce when precisely in

May that visit will take place. The circumstances may however leave the option to B, as would be the case if the contract expressly left to B the choice of the precise dates, or where, for example, it was understood that some of B's staff who are often absent on business trips must be present when A's experts arrive (see Article 6.1.1(b)).

2. A, a building contractor, encounters unusual difficulties when excavating a site and needs special equipment to continue the work which it does not have. A immediately telephones B, another contractor, who has the necessary equipment and agrees to lend it to A. Nothing however is said as to when the equipment should be delivered to A. Performance is then to take place "within a reasonable time" in the circumstances. Since the work has been interrupted because of the above-mentioned difficulties, A urgently needs to receive the equipment and in such a case "within a reasonable time" probably means that performance is due almost immediately (see Article 6.1.1(c)).

#### ARTICLE 6.1.2

*(Performance at one time or in instalments)*

**In cases under Article 6.1.1(b) or (c), a party must perform its obligations at one time if that performance can be rendered at one time and the circumstances do not indicate otherwise.**

#### COMMENT

A party's performance is of necessity sometimes rendered at one time (e.g. delivery of a single object), or, alternatively, must take place over a period of time (e.g. construction). There are however also cases where it can be rendered either at one time or in instalments (e.g. delivery of quantities of goods). This Article addresses the latter situation, in circumstances where there is no contractual provision as to how such performance should be rendered, or where it is not determinable from the contract. The principle stated is that performance is due at one time, unless the circumstances indicate otherwise.

#### Illustrations

1. A promises to deliver 100 tons of coal to B "in March". It would be materially possible and perhaps convenient for A to deliver the 100 tons in instalments, for instance 25 tons each week



of the month. In principle, however, according to Article 6.1.2, A must deliver the 100 tons at one time.

2. The facts are the same as in Illustration 1, except that B needs the coal gradually, to meet the needs of its operations. B also has limited storage facilities and could not cope adequately with a consignment of 100 tons at any one time. A knows of B's specific needs. Here the circumstances suggest that A should deliver in instalments during the month of March.

### ARTICLE 6.1.3

#### *(Partial performance)*

**(1) The obligee may reject an offer to perform in part at the time performance is due, whether or not such offer is coupled with an assurance as to the balance of the performance, unless the obligee has no legitimate interest in so doing.**

**(2) Additional expenses caused to the obligee by partial performance are to be borne by the obligor without prejudice to any other remedy.**

#### COMMENT

##### **1. Partial performance distinguished from performance at one time or in instalments**

The situation covered by this Article should be distinguished from that of Article 6.1.2.

Article 6.1.2 attempts to solve a preliminary question which concerns only certain special cases. If a party's performance can be rendered at one time or in instalments and if the contract does not make it clear or determinable how that party is to perform, it must in principle perform at one time.

This Article has a more general scope. It provides that at the time performance is due the obligee may in principle reject an offer of partial performance. This applies at maturity, irrespective of whether what is due then is a global performance or an instalment of a wider obligation (which, in some cases, has been previously determined on the basis of Article 6.1.2).

**Illustration**

1. A owes USD 1,000,000 to a bank and it has been agreed that A will pay back USD 100,000 on the first day of each month, starting in January. On 1 April A offers to reimburse only USD 50,000, and the balance two weeks later. In principle, the bank is entitled to refuse A's proposal.

**2. Obligor entitled in principle to reject partial performance**

When performance is due at maturity (be it the whole performance or an instalment), that which is due must be performed completely. In principle, the obligor may reject an offer of partial performance, whether or not it is coupled with an assurance as to the balance of the performance, since it is entitled to receive the whole of what was stipulated. Subject to what will be said below, partial performance normally constitutes a breach of contract. A party who does not obtain full performance at maturity may resort to the available remedies. As a rule, the obligor has a legitimate interest in requiring full performance of what was promised at the time that performance is due.

The obligor may of course also refrain from rejecting the offer to perform in part, while reserving its rights as to the breach, or may accept it without any reservation, in which case partial performance can no longer be treated as a non-performance.

**Illustration**

2. A wishes to open a branch office in country X and rents the necessary office space in a building under construction, due to be finished in time for the move on 1 September. On that date, only four of the ten offices are made available to A, with an assurance that the remaining six will be ready in one month. In principle, A may refuse to move into those four offices.

**3. Obligor's right to reject partial performance conditional on its legitimate interest in so doing**

There may be situations where the obligor's legitimate interest in receiving full performance is not apparent and where temporary acceptance of partial performance will not cause any significant harm to the obligor. If the party tendering partial performance proves this to be the case, the obligor cannot then refuse such partial performance (subject to paragraph (2)), and there is no non-performance in such cases. This may be seen as a consequence of the general principle of good faith and fair dealing enunciated in Article 1.7.

**Illustration**

3. An airline promises to transport 10 automobiles from Italy to Brazil in one single consignment due to be delivered on a definite date. When performance is due, some circumstances make it difficult, although not impossible, for the airline to find sufficient space in a single aircraft. The airline suggests making two successive deliveries within a week. It is established that this will cause no inconvenience to the purchaser of the cars, which will not actually be used before the following month. In such a case the obligee has no legitimate interest in refusing partial performance.

**4. Additional expenses entailed by partial performance to be borne by obligor**

If partial performance is accepted, it may entail additional expenses for the obligee. In all cases, such expenses are to be borne by the other party. If partial performance amounts to a non-performance (as it usually does), these expenses will be part of the damages, without prejudice to any other available remedy. If partial performance does not amount to a non-performance (the obligee has been shown not to have any legitimate interest in rejecting the offer of partial performance, or has found the offer to be acceptable without reservation), it will only be entitled to those expenses.

**Illustration**

4. The facts are the same as in Illustration 3. If the purchaser has to meet additional expenses on account of having to make double arrangements for picking up the cars at the airport, those extra costs will be borne by the airline.

**ARTICLE 6.1.4***(Order of performance)*

**(1) To the extent that the performances of the parties can be rendered simultaneously, the parties are bound to render them simultaneously unless the circumstances indicate otherwise.**

**(2) To the extent that the performance of only one party requires a period of time, that party is bound to render its performance first, unless the circumstances indicate otherwise.**

**COMMENT**

In bilateral contracts, where each of the parties has an obligation towards the other, the basic but complex question arises of which party is to perform first. If the parties have not made any specific arrangements, then in practice much will depend on usages and it must also be recalled that there are often several obligations on each side which may have to be performed at different times.

This Article states two broad principles, while recognising that in both cases the circumstances may indicate otherwise. In effect, the main purpose of this Article is to draw the parties' attention to the problem of order of performance, and to encourage them, where necessary, to draft appropriate contractual provisions.

A distinction is drawn between cases where the parties' performances can be rendered simultaneously and those where the performance of only one party requires a period of time.

**1. Simultaneous performance to be made when possible**

In the first situation, the rule is that the parties are bound to perform simultaneously (paragraph (1)). A seller is entitled to payment on delivery but circumstances may indicate otherwise, for example any exception originating from the terms of the contract or from usages which may allow a party to perform some time after the other.

**Illustration**

1. A and B agree to barter a certain quantity of oil against a certain quantity of cotton. Unless circumstances indicate otherwise, the commodities should be exchanged simultaneously.

**2. Exception where performance requires a period of time**

If the performance of only one party's obligation by its very nature requires a period of time, for example in construction and most service contracts, the rule established in paragraph (2) is that that party is bound to render its performance first. Circumstances may frequently however indicate the contrary. Thus, insurance premiums are normally paid in advance, as also are rent and freight charges. In construction contracts, payments are usually made in agreed instalments throughout the duration of the work.

**Illustration**

2. A promises to write a legal opinion to assist B in an arbitration. If no arrangement is made as to when A should be paid for the services, A must prepare the opinion before asking to be paid.

**3. Relation of order of performance to withholding of performance**

This Article sets out the rules which will condition the application of Article 7.1.3 concerning the withholding of performance.

**ARTICLE 6.1.5**

*(Earlier performance)*

**(1) The obligee may reject an earlier performance unless it has no legitimate interest in so doing.**

**(2) Acceptance by a party of an earlier performance does not affect the time for the performance of its own obligations if that time has been fixed irrespective of the performance of the other party's obligations.**

**(3) Additional expenses caused to the obligee by earlier performance are to be borne by the obligor, without prejudice to any other remedy.**

**COMMENT****1. Obligor in principle entitled to reject earlier performance**

When performance is due at a certain moment (to be determined in accordance with Article 6.1.1), it must take place at that time and in principle the obligee may reject an earlier performance. Usually, the time set for performance is geared to the obligee's activities, and earlier performance may cause it inconvenience. The obligee has therefore a legitimate interest in refusing it. Earlier performance, in principle, constitutes non-performance of the contract.

The obligee may of course also abstain from rejecting an earlier performance while reserving its rights as to the non-performance. It may also accept such performance without reservation, in which case earlier performance can no longer be treated as non-performance.

#### **Illustration**

1. A agrees to carry out the annual maintenance of all lifts in B's office building on 15 October. A's employees arrive on 14 October, a day on which important meetings, with many visitors, are taking place in the building. B is entitled to refuse such earlier performance which would cause it obvious inconvenience.

#### **2. Obligee's right to reject earlier performance conditional on its legitimate interest in so doing**

Situations may arise in which the obligee's legitimate interest in timely performance is not apparent and when its accepting earlier performance will not cause it any significant harm. If the party offering earlier performance proves this to be the case, the other party cannot reject earlier performance.

#### **Illustration**

2. The facts are the same as in Illustration 1, except that neither 14 nor 15 October has any special significance. A can probably prove that B has no legitimate interest in refusing the earlier performance.

#### **3. Effect of acceptance by obligee on its own performance of earlier performance of the other party's obligations**

If one party accepts earlier performance by the other, the question arises of whether this affects the time for performance of its own obligations. Paragraph (2) deals with cases where obligations are due at a certain time which is not linked to the performance of the other party's obligations; that time for performance remains unchanged.

This provision does not however deal with the converse case where the performances are linked in time. Several situations may then arise. This circumstance may in itself establish the obligee's legitimate interest in rejecting earlier performance. If earlier performance is thus rejected, the obligee's time of performance is unaffected. If earlier performance is accepted with all due reservations as to the non-performance involved, the obligee may also reserve its rights as to its

time for performance. If earlier performance is acceptable to the obligee it may at the same time decide whether or not to accept the consequences as regards its own obligations.

### Illustrations

3. B undertakes to deliver goods to A on 15 May and A to pay the price on 30 June. B wishes to deliver the goods on 10 May and A has no legitimate interest in refusing such earlier performance. This will however have no effect on the time agreed for payment of the price, which was determined irrespective of the date of delivery.

4. B undertakes to deliver goods to A on 15 May and A to pay the price “on delivery”. If B tenders the goods on 10 May, A, depending on the circumstances, may reject such earlier performance, claiming that it is not in a position to pay at that date, take delivery of the goods subject to observing the original deadline for payment of the price, or decide to accept the goods and pay for them immediately.

### **4. Additional expenses entailed by earlier performance to be borne by the performing party**

If earlier performance is accepted, it may entail additional expenses for the obligee. In all cases, such expenses are to be borne by the other party. If earlier performance amounts to non-performance (the normal case), those expenses will be part of the damages, without prejudice to any other remedy available. If earlier performance does not amount to non-performance (the obligee has been shown not to have any legitimate interest in rejecting the offer of earlier performance, or has found that offer to be acceptable without reservation), the obligee will only be entitled to those expenses.

### Illustration

5. A has no legitimate interest in refusing delivery of goods on 10 May instead of 15 May, but some additional storage fees are payable for those five extra days. Those costs will be borne by B.

**ARTICLE 6.1.6***(Place of performance)*

**(1) If the place of performance is neither fixed by, nor determinable from, the contract, a party is to perform:**

**(a) a monetary obligation, at the obligee's place of business;**

**(b) any other obligation, at its own place of business.**

**(2) A party must bear any increase in the expenses incidental to performance which is caused by a change in its place of business subsequent to the conclusion of the contract.**

**COMMENT****1. Place of performance fixed by, or determined from, the contract when possible**

The place where an obligation is to be performed is often determined by an express term of the contract or is determinable from it. It is obvious, for instance, that an obligation to build must be performed on the construction site, and that an obligation to transport goods must be performed in accordance with the agreed route.

**2. Need for suppletive rules**

Rules are however needed to cover cases in which the contract is silent on the matter and circumstances do not indicate where performance should take place. Paragraph (1) provides two solutions.

The general rule is that a party is to perform its obligations at its own place of business. The second rule is specific to monetary obligations where the converse solution applies, namely that the obligor is to perform its obligations at the obligee's place of business (subject to the application of Article 6.1.8 concerning payments by funds transfers).

These solutions may not be the most satisfactory in all cases, but they do reflect the need for rules where the parties have not made any other arrangement or where the circumstances do not indicate otherwise.



### Illustrations

1. A wishes some of its engineers to learn the language of country X, where they will be employed for some time. It agrees with B, a language school, for a series of intensive lessons. If nothing else is stipulated, the lessons are to take place at B's place of business (see Article 6.1.6(1)(b)).
2. The facts are the same as in Illustration 1. The language school sends its bill to A. The cost of the lessons must, in principle, be paid at B's place of business (see Article 6.1.6(1)(a)).

### **3. Consequences of change in a party's place of business subsequent to conclusion of contract**

In view of the importance of the parties' respective places of business for the application of paragraph (1), it is necessary to cater for the situation where a party changes its location after the conclusion of the contract, a move which may involve additional expense for the performing party. The rule established in paragraph (2) is that each party must bear any such increase of expenses occasioned by a change in its place of business.

It is moreover possible that a party's move may entail other inconvenience for the other party. The obligation to act in good faith (Article 1.7) and the duty to cooperate (Article 5.1.3) will often impose on the moving party an obligation to inform the other party in due time so as to enable the latter to make such arrangements as may be necessary.

### Illustrations

3. A enters into a technical assistance agreement with B, under the terms of which A undertakes to train ten of B's engineers for a period of two months on A's premises. The engineers are to be accommodated at a local hotel which offers very reasonable rates on account of A's location in a rural area. After the agreement has been concluded, but before B's engineers arrive, A notifies B that it has moved to the capital city where hotel rates are much higher. Irrespective of whether the initial costs of accommodation were to be paid by A or by B, the additional costs will be borne by A.
4. Each year on 3 May, A must pay royalties to B at B's place of business. B moves to another country, to which it takes some time (e.g. two months) for a payment to arrive. A formerly gave its bank the transfer order on or about 15 April, but from now on the order must be given towards the end of March at the latest if A

wishes to avoid late payment. B is under a duty to inform A of its new place of business in sufficient time to permit A to make the necessary arrangements for payment and B will bear the additional costs.

**ARTICLE 6.1.7**

*(Payment by cheque or other instrument)*

**(1) Payment may be made in any form used in the ordinary course of business at the place for payment.**

**(2) However, an obligee who accepts, either by virtue of paragraph (1) or voluntarily, a cheque, any other order to pay or a promise to pay, is presumed to do so only on condition that it will be honoured.**

**COMMENT**

Discharge of monetary obligations is frequently made by cheques or similar instruments, or by transfers between financial institutions. The problems involved have however very seldom been the subject of codification, one notable exception being the *UNCITRAL Model Law on International Credit Transfers*. Without attempting to provide a detailed regulation, which would not be compatible with the very rapid evolution of techniques in this field, Articles 6.1.7 and 6.1.8 establish some basic principles which should be of assistance in regard to international payments.

**1. General rule regarding form of payment**

Paragraph (1) allows for payment to be made in any form that is usual at the place for payment. Subject to the reservation contained in paragraph (2), the obligor may for instance pay in cash, by cheque, banker's draft, a bill of exchange, credit card, or in any other form such as the newly developing electronic means of payment, provided it chooses a mode that is usual at the place for payment, i.e. normally at the obligee's place of business. In principle, the obligee should be satisfied to receive payment in a form that is customary at its place of business.

### Illustration

1. A, an importer in Luxembourg, receives a bill for goods bought from B, a firm in Central America, and sends a eurocheque in payment. B may reject this mode of payment if the banks in its country are not familiar with eurocheques.

## **2. Presumption that payment will be honoured a condition for acceptance**

Paragraph (2) states the generally recognised principle according to which the obligee's acceptance of an instrument that has to be honoured by a financial institution or another person (a third person or the obligor itself) is given only on condition that the instrument will actually be honoured.

The presumption can sometimes be overturned by usages. There are for instance countries where delivery of instruments such as certified cheques, banker's drafts and cashier's cheques is considered as being equivalent to payment by the obligor, with the consequence that the risk of the bank's insolvency is transferred to the obligee. In such countries, the rule in Article 6.1.7(2) would apply only to so-called personal cheques.

### Illustration

2. A, a contractor, must pay B, a sub-contractor, for work completed by the latter on a building site. A is experiencing a cash-flow crisis as its client C is late in paying the first instalment due. C has however given A a set of promissory notes up to the amount of its debt. A offers to pay B by assigning a sufficient number of promissory notes. If B accepts them (in this case it probably does not have to do so as this is not a usual form of payment), the effectiveness of the payment by A to B is conditional on C's honouring the promissory notes at maturity.

## **ARTICLE 6.1.8**

*(Payment by funds transfer)*

**(1) Unless the obligee has indicated a particular account, payment may be made by a transfer to any of the financial institutions in which the obligee has made it known that it has an account.**

**(2) In case of payment by a transfer the obligation of the obligor is discharged when the transfer to the obligee's financial institution becomes effective.**

#### COMMENT

##### **1. Admissibility of funds transfers**

Although the principle enunciated in Article 6.1.6 that payment of a monetary obligation should be made at the obligee's place of business still stands, paragraph (1) of this Article provides that it can also be made to one of the financial institutions in which the obligee has made it known that it keeps an account. If however the obligee has indicated a particular account, payment should then be made to that account. Naturally, the obligee can also make it known that it does not wish payment to be made by transfer.

#### Illustration

1. A, a shipyard established in country X, repairs a ship belonging to B, a company from country Y, and the bill is sent on a letter-head that mentions a bank account in country X and another in country Y. Unless A states that payment has to be made to the account in country X, or by a means other than a bank transfer, B is entitled to make payment to the account in country Y.

##### **2. Time at which the obligor's obligation is discharged by a funds transfer**

Paragraph (2) of this Article deals with the difficult question of determining when a payment by funds transfer is to be considered as completed, i.e. when the obligor's obligation is discharged. This matter is of importance, for example when deciding whether a payment was made in time, or in the event of one of the banks not forwarding the funds it has received. The choice of a satisfactory solution has been the centre of considerable controversy in many countries and international fora. Various possible times have been suggested, such as that of the debiting of the account of the transferor, the crediting to the account of the transferee bank, the notice of credit to that account, the decision of the transferee bank to accept a credit transfer, the entry of credit to the transferee's account, the notice of credit to the transferee, etc. The matter is further complicated by the changes in the procedures for the transfer of funds entailed by new

electronic transfer mechanisms, while bank practices may also differ from one case to another.

This uncertainty makes it extremely difficult to establish a definite rule providing when payment by a transfer is completed. Paragraph (2) of this Article nevertheless serves a useful purpose in that it states the basic principle which will permit the finding of a more precise rule in each case. Such a payment will be effective when the transfer to the obligee's financial institution becomes effective, a solution founded on the notion that the institution acts as the obligee's agent. This means that the payment will not be effective simply because an order has been given to the transferor's financial institution, and the transferor's account has been debited. However, payment is effective before the transferee is notified or credited with it by its financial institution, although the precise moment at which payment to the obligee's financial institution can be considered as being effective will depend on banking practices in the case concerned.

#### Illustration

2. A, a licensee, gives its bank, C, a transfer order for USD 5,000, royalties due to B, a licensor, who has an account with bank D. C debits A's account, but fails to forward the funds to D and becomes bankrupt. A has not effectively paid B.

### ARTICLE 6.1.9

#### *(Currency of payment)*

**(1) If a monetary obligation is expressed in a currency other than that of the place for payment, it may be paid by the obligor in the currency of the place for payment unless**

**(a) that currency is not freely convertible;  
or**

**(b) the parties have agreed that payment should be made only in the currency in which the monetary obligation is expressed.**

**(2) If it is impossible for the obligor to make payment in the currency in which the monetary obligation is expressed, the obligee may require payment in the currency of the place for payment, even in the case referred to in paragraph (1)(b).**

**(3) Payment in the currency of the place for payment is to be made according to the applicable rate of exchange prevailing there when payment is due.**

**(4) However, if the obligor has not paid at the time when payment is due, the obligee may require payment according to the applicable rate of exchange prevailing either when payment is due or at the time of actual payment.**

#### COMMENT

Monetary obligations are usually expressed in a certain currency (currency of account), and payment must normally be made in the same currency. However, when the currency of the place for payment is different from the currency of account, paragraphs (1) and (2) of this Article provide for those cases where the obligor may or must make payment in the former currency.

#### **1. Monetary obligation expressed in currency different from that of place for payment**

As a general rule, the obligor is given the alternative of paying in the currency of the place for payment, which may have definite practical advantages and, if that currency is freely convertible, this should cause no difficulty to the obligee.

If, however, the currency of the place for payment is not freely convertible, the rule does not apply. Parties may also exclude the application of the rule by agreeing that payment is to be made only in the currency in which the monetary obligation is expressed (*effectivo* clause). If it has an interest in the payment actually being made in the currency of account, the obligee should specify this in the contract.

#### Illustrations

1. A company from country X receives an order for machinery from a buyer from country Y, the price being expressed in US dollars. According to Article 6.1.6, payment of that monetary obligation must in principle be made at the obligee's place of business, i.e. country X. If the company from country Y finds it more convenient, it may pay the price in euro which is the currency of X (see Article 6.1.9(1)).

2. The same company from country X frequently needs to buy from suppliers in country Z certain parts to be included in the machines, and has stipulated that the buyer from country Y should

pay only in US dollars. In this case, payment may only be made in dollars (see Article 6.1.9(1)(b)).

3. The same company from country X has a plant in country W, where the machines will be assembled. The contract provides that the buyer from country Y has to pay the price to the firm's subsidiary in country W. Since the currency of country W is not convertible, payment may only be made in dollars (see Article 6.1.9(1)(a)).

## **2. Impossibility for obligor to make payment in currency in which obligation is expressed**

In some instances, the obligor may find it impossible to make payment in the currency in which the obligation was expressed. This may be the result of the application of exchange regulations or other mandatory rules, or due to any other cause preventing the obligor from obtaining that currency in sufficient quantity. Paragraph (2) gives the obligee the option of requiring payment in the currency of the place for payment, even if the contract contains an *effectivo* clause. This is an additional option open to the obligee who may find it acceptable or even advantageous in the circumstances. It does not preclude the exercise of any available remedy in the event of the obligor's inability to pay in the currency of account amounting to a non-performance of the contract (e.g. damages).

### **Illustration**

4. A, a Swiss bank, lends USD 1,000,000 to B, to be reimbursed in Geneva. At maturity, B is unable to find the necessary US dollars. A, which knows that B has deposits in Swiss francs with another local bank, may require payment in Swiss francs, even though the loan agreement stipulated that reimbursement was to be made only in US dollars (see Article 6.1.9(2)).

## **3. Determination of applicable rate of exchange**

Paragraphs (3) and (4) deal with the problem of the determination of the rate of exchange to be chosen when payment is made in the currency of the place for payment rather than in a different currency stipulated in the contract. This may occur when the obligor avails itself of paragraph (1), or the obligee the provisions of paragraph (2).

Two widely accepted solutions are offered. In normal cases, the rate of exchange is that prevailing when payment is due. If, however, the obligor is in default, the obligee is given an option between the rate of exchange prevailing when payment was due or the rate at the time of actual payment.

The double reference to the “applicable” rate is justified by the fact that there may be different rates of exchange depending on the nature of the operation.

#### **Illustration**

5. The facts are the same as in Illustration 4. A chooses to be reimbursed in Swiss francs (CHF) and payment, which was due on 10 April, actually takes place on 15 September. The rate of exchange on 10 April was 2 Swiss francs to 1 US dollar. By 15 September it has become CHF 2,15 to USD 1. A is entitled to apply the latter rate. If the US dollar had depreciated rather than increased in value, A would have chosen the rate applicable on 10 April.

#### **ARTICLE 6.1.10**

*(Currency not expressed)*

**Where a monetary obligation is not expressed in a particular currency, payment must be made in the currency of the place where payment is to be made.**

#### **COMMENT**

Determining the currency of payment gives rise to a special problem if the contract does not state the currency in which a monetary obligation is due. Although such cases may be infrequent, they do exist; a contract may for example state that the price will be the “current price”, or that it will be determined by a third person, or that some expenses or costs will be reimbursed by one party to the other, without specifying in which currency those sums are due. The rule laid down in Article 6.1.10 is that in such situations payment must be made in the currency of the place where payment is to be made.

Article 6.1.10 is not concerned with the currency in which damages are to be assessed, a matter dealt with in Article 7.4.12 in the context of non-performance.



**Illustration**

A, a Japanese client, instructs its broker, B, to buy shares on the Shanghai stock exchange. If B pays for them in Chinese Yuan Renminbi (CNY), should A be billed in Yuan Renminbi or in Japanese Yen? If A is to pay B in Japan, it will pay in Yen.

**ARTICLE 6.1.11**

*(Costs of performance)*

**Each party shall bear the costs of performance of its obligations.**

**COMMENT**

The performance of obligations often entails costs, which may be of different kinds: transportation costs in delivering goods, bank commission in making a monetary transfer, fees to be paid when applying for a permission, etc. In principle, such costs are to be borne by the performing party.

Other arrangements may of course be made by the parties and there is nothing to prevent the performing party from including those costs in advance in the price it quotes. The rule set out in Article 6.1.11 applies in the absence of such arrangements.

The provision states who shall bear the costs, not who shall pay them. Usually, it will be the same party, but there may be different situations, for example where tax regulations place the burden of payment on a specific party. In such cases, if the person who has to pay is different from the person who must bear the costs under Article 6.1.11, the latter must reimburse the former.

**Illustration**

A, a consultant, agrees to send five experts to perform an audit of B's company. Nothing is said concerning the experts' travel expenses, and A does not take those costs into account when determining its fees. A may not add the travel expenses to the bill.

**ARTICLE 6.1.12***(Imputation of payments)*

**(1) An obligor owing several monetary obligations to the same obligee may specify at the time of payment the debt to which it intends the payment to be applied. However, the payment discharges first any expenses, then interest due and finally the principal.**

**(2) If the obligor makes no such specification, the obligee may, within a reasonable time after payment, declare to the obligor the obligation to which it imputes the payment, provided that the obligation is due and undisputed.**

**(3) In the absence of imputation under paragraphs (1) or (2), payment is imputed to that obligation which satisfies one of the following criteria in the order indicated:**

**(a) an obligation which is due or which is the first to fall due;**

**(b) the obligation for which the obligee has least security;**

**(c) the obligation which is the most burdensome for the obligor;**

**(d) the obligation which has arisen first.**

**If none of the preceding criteria applies, payment is imputed to all the obligations proportionally.**

**COMMENT**

Articles 6.1.12 and 6.1.13 deal with the problem of imputation of payments. If an obligor owes several monetary obligations at the same time to the same obligee and makes a payment the amount of which is not sufficient to discharge all those debts, the question arises of the debts to which that payment applies.

Article 6.1.12 offers the obligor the possibility of imputing its payment to a particular debt, provided that any expenses and interest due are discharged before the principal. In the absence of any imputation by the obligor, this provision enables the obligee to impute the payment received, although not to a disputed debt. Paragraph (3) lays down criteria which will govern in the absence of any imputation by either party.

**Illustration**

A receives under separate contracts three loans, each of USD 100,000, from bank B payment of which is due on 31 December. B receives USD 100,000 from A on 2 January with the imprecise message: "Reimbursement of the loan". B pays little attention to the matter and at first does not react, but three months later sues A for payment of the remaining USD 200,000 and the parties disagree as to which of the loans had been reimbursed by the January payment. B had similar security in each case, but the interest rates were not the same: 8% on the first loan, 8,50% on the second and 9% on the third. The January payment will be imputed to the third loan.

**ARTICLE 6.1.13**

*(Imputation of non-monetary obligations)*

**Article 6.1.12 applies with appropriate adaptations to the imputation of performance of non-monetary obligations.**

**COMMENT**

The problem of imputation of payments normally concerns monetary obligations, but similar difficulties may sometimes occur in relation to obligations of a different nature. Article 6.1.13 provides that the rules governing monetary obligations will apply, with appropriate adaptations also to these cases.

**Illustration**

A is performing construction work on several sites in an African country and, through five separate and successive contracts with B, purchases different quantities of cement, all to be delivered in Antwerp on the same date and to be loaded on the same ship. The contracts are similar, except that the third and fifth contracts stipulate very high liquidated damages in the event of late delivery. On account of certain difficulties, B can only deliver part of what it was supposed to. Upon delivery B is entitled to specify that the quantities delivered are to be imputed to the third and fifth contracts.

**ARTICLE 6.1.14**

*(Application for public permission)*

**Where the law of a State requires a public permission affecting the validity of the contract or its performance and neither that law nor the circumstances indicate otherwise**

**(a) if only one party has its place of business in that State, that party shall take the measures necessary to obtain the permission;**

**(b) in any other case the party whose performance requires permission shall take the necessary measures.**

**COMMENT**

If the validity or the performance of a contract is subject to compliance with public permission requirements, several issues arise as to who has the burden of filing the application (see Article 6.1.14), the time for filing (see Article 6.1.15), the legal consequences of failure to obtain an administrative decision in due time (see Article 6.1.16) and the rejection of the application (see Article 6.1.17).

**1. Scope of the permission requirement**

The Principles do not deal with the relevance of public permission requirements. What kind of public permission is required, if any, is to be determined under the applicable law, including the rules of private international law.

Courts tend to give effect only to the public permission requirements of the *lex fori*, and sometimes to those prescribed by the *lex contractus*. Arbitral tribunals may enjoy wider discretion than courts in deciding which public permissions are relevant to the contract.

Under the relevant conflict of laws rules public permission requirements of the law of other jurisdictions connected with the contract may also come into play (see Article 9(3) of *EC Regulation No. 593/2008 (Rome I)*; Article 11(2) of the 1994 *Inter-American Convention on the Law Applicable to International Contracts*). Long-arm statutes in some jurisdictions too may impose public permission requirements on licensees or subsidiaries of companies located abroad. This Article assumes that the requirements prescribed by the applicable law are to be observed.

a. *Broad notion of “public permission”*

The term “public permission” is to be given a broad interpretation. It includes all permission requirements established pursuant to a concern of a public nature, such as health, safety, or particular trade policies. It is irrelevant whether a required licence or permit is to be granted by a governmental or by a non-governmental institution to which Governments have delegated public authority for a specific purpose. Thus, the authorisation of payments by a private bank pursuant to foreign exchange regulations is in the nature of a “public permission” for the purposes of this Article.

b. *Timing of public permission*

The provisions on public permissions refer primarily to those required by the applicable law or by a regulation in force at the time of the conclusion of the contract. However, these provisions may also apply to public permissions that may be introduced after the conclusion of the contract.

c. *Public permission may affect the contract in whole or in part*

The provisions on public permissions apply both to those requirements affecting the contract as a whole and to those merely affecting individual terms of the contract. However, where the legal consequences of failing to obtain a public permission differ according to whether such permission affects the contract in whole or in part, different rules are established (see Articles 6.1.16 (2) and 6.1.17).

d. *Public permission may affect the validity or performance of a contract*

The absence of the required permission may affect the validity of a contract or render its performance impossible. Notwithstanding differences in the legal consequences of failing to obtain a required public permission, the problems raised in connection with the application for, or the obtaining of, a public permission are the same. As to the further consequences, Article 6.1.17(2) provides that the rules on non-performance apply to a situation where the refusal of a permission makes the performance of a contract impossible in whole or in part.

## **2. Duty to inform of the existence of a public permission requirement**

There is as a rule no duty to provide information concerning the requirement to obtain a public permission. However, the existence of

such a requirement must be disclosed by the party upon whom rests the burden of obtaining a public permission when such permission is required under rules which are not generally accessible. Thus, the overriding principle of good faith and fair dealing (see Article 1.7) may require the party whose place of business is located in the State requiring a public permission to inform the other party of the existence of that requirement. Failure to do so may lead a court to disregard the permission requirement altogether or to conclude that the party who failed to communicate the existence of the requirement implicitly guaranteed that it would be obtained.

### **3. Which party is bound to take measures to obtain a public permission**

#### *a. Party with place of business in State requiring public permission*

The rule set out in sub-paragraph (a) of this Article which places the burden to apply on the party who has its place of business in the State which requires the relevant public permission reflects current international trade practices. It is that party who is in the best position to apply promptly for a public permission, since it is probably more familiar with the application requirements and procedures.

If a party needs further information from the other to file an application (e.g. information relating to the final destination of the goods, or information as to the purpose or subject matter of the contract), the other party must furnish such information pursuant to the duty of co-operation (see Article 5.1.3). Should that party not furnish such information it may not rely on the obligation of the first party. This duty to cooperate with the other party applies even if the contract stipulates that one of the parties bears the burden of applying for a public permission. Thus, if the parties have incorporated in their contract the term “ex works”, which imposes far-reaching obligations on the buyer, the seller is nevertheless bound “to render the buyer, at the latter’s request, risk and expense, every assistance in obtaining [...] any export licence or other official authorisation necessary for the export of the goods” (INCOTERMS 2000, A 2, see also B 2).

#### *b. Party whose performance requires public permission*

Sub-paragraph (b) of this Article contemplates those cases where none of the parties has a place of business in the State requiring the permission. It also envisions a contract which is truly international notwithstanding the fact that both parties have their places of business in that State. In either case, the party whose performance requires the

public permission is bound to take the necessary measures to obtain such a permission.

#### Illustration

1. A, a contractor whose place of business is located in country X, sells a plant on a turn-key basis to B, whose place of business is located in country Y. Acceptance is to take place after performance tests in country Y. On the one hand, A has to apply for all public permissions required in country X, as well as for permissions in third countries (transit, sub-deliveries). On the other, B has to apply for import licences, as well as for all other permissions relating to the site, the use of local services, and the technology imported into country Y. A is also bound to furnish the information and documentation needed by B to obtain import licences and other permissions related to B's performance. A is not responsible for applying for public permissions in country Y, unless this is agreed in the contract or is required, explicitly or implicitly, by the applicable law or the circumstances of the case (e.g. the applicable law may require certain technical permits in country Y to be applied for by the licensor).

#### *c. Suppletory nature of provisions on public permissions*

The purpose of this Article is to determine the party who must apply for a public permission in those cases where it is not clear who is to bear that burden. It is a suppletory rule to be applied when neither the contract, nor the law requiring the permission or the circumstances specify which party is under an obligation to apply for the required public permission.

#### Illustration

2. The law of country X subordinates the granting of an export licence for computers to a sworn declaration indicating the country where the computers will ultimately be sent. However, neither the contract nor the law of country X indicates which party bears the burden of applying for a licence. Since it is reasonable to suppose that only the buyer knows what it plans to do with the computers, the policy behind the rule imposing the permission requirement leads to the conclusion that it is the buyer who has to file the application.

**4. Nature of obligation to take the “necessary measures”**

The party who has to apply for the permission must take the “necessary measures” to obtain such permission, but is not responsible for the outcome of the application. That party is bound to exhaust available local remedies to obtain the permission, provided that they have a good chance of success and that resorting to local remedies appears reasonable in view of the circumstances of the case (e.g. the value of the transaction, time constraints).

Which measures have to be taken depends on the relevant regulations and the procedural mechanisms available in the State where the permission is to be granted. The obligation is in the nature of an obligation of best efforts (see Article 5.1.4(2)).

**Illustration**

3. A, a principal whose place of business is in country X, enters into a contract with B, a self-employed agent, whose place of business is in country Y. B, who has no authority to conclude contracts, is to represent A in countries Y and Z. Among other duties, B must exhibit A’s goods at a fair which is to take place in country Z. B must apply for all permissions which are required to undertake these professional activities in countries Y and Z. B’s duty to take “necessary measures” includes that of applying for public permissions required to import A’s goods temporarily into countries Y and Z, as well as any other public permission that would enable B to participate in the fair. However, unless otherwise agreed, B is not required to apply for public permissions required for goods imported through B by customers located in countries Y and Z.

**ARTICLE 6.1.15**

*(Procedure in applying for permission)*

**(1) The party required to take the measures necessary to obtain the permission shall do so without undue delay and shall bear any expenses incurred.**

**(2) That party shall whenever appropriate give the other party notice of the grant or refusal of such permission without undue delay.**



**COMMENT****1. Time for filing an application**

The party under an obligation to obtain a public permission must take action immediately after the conclusion of the contract and pursue this action as necessary under the circumstances.

**2. Expenses**

According to Article 6.1.11, each party shall bear the costs of performance of its obligations. This rule has been restated in paragraph (1) of this Article for the sake of clarity.

**3. Duty to give prompt notice of the grant or refusal of the permission**

The parties to the contract need to know as soon as possible whether the permission can be obtained. Accordingly, paragraph (2) of this Article provides that the party required to take the necessary measures must inform the other of the outcome of the application. This duty of information extends to other relevant facts, such as for example the timing and outcome of the application, whether a refusal is subject to appeal and whether an appeal is to be lodged.

**4. Duty to give notice “whenever appropriate”**

The “appropriateness” of giving notice of the grant or refusal refers to the need to give notice and the manner of providing it. The necessity of giving notice obviously exists where such notice is required by law, but may also be inferred from the mere fact that a permission requirement is referred to in the contract.

The “appropriateness” of the duty to give notice is also related to the relevance of the information to be provided. Accordingly, the applying party is not bound to inform the other party of the outcome of that application in cases where the latter party obtains the information from the granting authority, or where applications for permissions are regularly granted. The fact that the permission is, contrary to normal practice, refused in a given case makes the obligation to inform more compelling.

This Article does not establish particular requirements concerning the formalities relating to the communication (see Article 1.10).

## 5. Consequences of the failure to inform

Failure to provide information regarding the grant or refusal of the permission amounts to non-performance. Accordingly, the general consequences of non-performance, as set forth in Chapter 7, apply. The duty to give notice of the grant of the public permission is a contractual obligation arising at the time the contract comes into existence. The duty to give notice of the refusal of the permission is part of the duty to take the “necessary measures” to obtain the permission under Article 6.1.14 (see Comment 4).

### Illustrations

1. A, whose place of business is in country X, and B, a contractor, enter into a contract for the construction of a plant in country X. The parties agree that B is not bound to begin the construction and A’s advance payments are not due until the grant of a permission by the authorities of country X.

A applies for and obtains the permission but fails to inform B that the permission has been granted. Two months later, B learns through inquiries with the authorities of country X that the permission has been granted and begins work on the construction of the plant.

Although the parties had agreed that their performances were due as of the time of the granting of the permission, A’s failure to inform B that the permission has been granted precludes A from relying on B’s failure to perform as of that date (see Article 7.1.2). Thus, the contractual period begins to run for B as from when it learns of the granting of the permission.

Moreover, B may also claim damages if it is able to establish, for example, damage resulting from failure to use its production capacity, additional costs arising from storing raw materials during that two-month period, etc. (see Article 7.4.1 *et seq.*). A, who from the very beginning had notice of the grant of the permission, must observe the original date of its performance, as provided for in the contract. If A fails to make an advance payment due four weeks after the granting of the permission, A must pay interest as from that date.

2. The facts are the same as in Illustration 1, except that the proper authority simultaneously informs A and B that the permission has been granted. B may not avail itself of A's failure to inform in order to postpone its performance, nor is it entitled to damages for A's failure to inform.

#### ARTICLE 6.1.16

*(Permission neither granted nor refused)*

**(1) If, notwithstanding the fact that the party responsible has taken all measures required, permission is neither granted nor refused within an agreed period or, where no period has been agreed, within a reasonable time from the conclusion of the contract, either party is entitled to terminate the contract.**

**(2) Where the permission affects some terms only, paragraph (1) does not apply if, having regard to the circumstances, it is reasonable to uphold the remaining contract even if the permission is refused.**

#### COMMENT

Whereas Articles 6.1.14 and 6.1.15 are concerned with the duties of the contracting parties, Articles 6.1.16 and 6.1.17 deal with the legal consequences in cases respectively where there has been no decision on the application within a given period or where the public permission has been refused.

##### **1. No decision taken as regards the permission**

Paragraph (1) of this Article deals with the “nothing happens” situation, that is to say a situation where permission has neither been granted nor refused within the agreed period or, where no period has been agreed, within a reasonable time from the conclusion of the contract. The reasons for the absence of a pronouncement may vary, for example the slow pace of processing the application, a pending appeal, etc. In any event there is no longer any reason to keep the parties waiting and either party is entitled to terminate the contract.

**2. Termination of the contract**

Remedies other than termination may be appropriate depending on the legal role played by the permission in the creation of the contractual obligations. This is in particular the case where the granting of the public permission is a condition for the validity of the contract, since in the absence of the permission either party may simply disregard the contract. The reason why this Article provides also in these cases for the termination of the contract is that the parties are, with a view to obtaining the permission, under a number of obligations which cannot be allowed to exist indefinitely.

The entitlement of the party responsible for obtaining the permission to terminate the contract under this Article is conditional on that party's having taken "the necessary measures" to that effect.

**Illustration**

1. A, situated in country X, sells rifles to B for resale by B in the hunting season starting in four months. The validity of the sale is subject to a public permission to be granted by the authorities of country X. No period is agreed for obtaining that permission. Notwithstanding the fact that A takes all the necessary measures to obtain the permission, after three months no decision has yet been taken on A's application. Either party may terminate the contract.

The termination envisaged under this Article has no consequences for the expenses so far incurred by the parties for the purpose of obtaining the permission. The expenses will be borne by the party who has assumed the risk of not obtaining the permission.

**3. Permission affecting individual terms only**

Where the permission affects some terms only of the contract, paragraph (2) of this Article excludes the right of termination in cases where, even if the permission had been refused, it would according to Article 6.1.17(1) nevertheless be reasonable to uphold the contract.

**Illustration**

2. A, situated in country X, enters into a contract with B, which contains a penalty clause for delay the validity of which is subject to a public permission to be granted by the authorities of country X. Notwithstanding the fact that A takes all the necessary measures to obtain the permission, time continues to pass without any decision being taken. It would be reasonable in the circumstances to uphold the contract. Even if the permission were to have been refused, neither party may terminate the contract.

**ARTICLE 6.1.17***(Permission refused)*

**(1) The refusal of a permission affecting the validity of the contract renders the contract void. If the refusal affects the validity of some terms only, only such terms are void if, having regard to the circumstances, it is reasonable to uphold the remaining contract.**

**(2) Where the refusal of a permission renders the performance of the contract impossible in whole or in part, the rules on non-performance apply.**

**COMMENT****1. Application for permission rejected**

This Article contemplates the situation where the application for a permission is expressly refused. The nature of the obligation imposed on the responsible party with respect to the application for the permission is such that a refusal under this Article is one which is not subject to an appeal which has a reasonable prospect of success (see Comment 4 on Article 6.1.14). Moreover, means of recourse against the refusal need not be exhausted whenever a final decision on the permission would be taken only after the time at which the contract could meaningfully be performed.

**2. Legal consequences of a refusal of permission**

The consequences of a refusal to grant the permission vary depending on whether the permission affects the validity of the contract or its performance.

*a. Refusal of permission affecting validity of the contract*

Where the permission affects the validity of the whole contract, a refusal renders the whole contract void, i.e. the contract is considered as never having come into being.

**Illustration**

1. A, situated in country X, enters into a contract with B, the validity of which is subject to a public permission to be granted by the authorities of country X. Notwithstanding the fact that A takes all the necessary measures to obtain the permission, A's application is refused. The contract is considered never to have come into existence.

Where, on the other hand, a refusal affects the validity of some terms only of the contract, only such terms are void, while the remaining part of the contract may be upheld provided that such a result is reasonable in the circumstances.

**Illustration**

2. A, situated in country X, enters into a contract with B, which contains a penalty clause for delay the validity of which is subject to a public permission to be granted by the authorities of country X. Notwithstanding the fact that A takes all the necessary measures to obtain the permission, A's application is refused. If it is reasonable in the circumstances, the contract will be upheld without the penalty clause.

**b. *Refusal rendering performance of the contract impossible***

If the refusal of the permission renders the performance impossible in whole or in part, paragraph (2) of this Article refers to the rules on non-performance embodied in Chapter 7.

**Illustration**

3. Under a contract entered into with B, A owes B USD 100,000. The transfer of the sum from country X, where A is situated, to B's bank account in country Y is subject to a permission by the Central Bank of country X. Notwithstanding the fact that A takes all the necessary measures to obtain the permission, A's application is refused. The refusal of the permission renders it impossible for A to pay B. The consequences of A's non-performance are determined in accordance with the provisions of Chapter 7.

The refusal of the permission may render the performance of a party impossible only in the State imposing the permission requirement, while it may be possible for that party to perform the same obligation elsewhere. In such cases the general principle of good faith and fair dealing (see Article 1.7) will prevent that party from relying on the refusal of the permission as an excuse for non-performance.

**Illustration**

4. The facts are the same as in Illustration 3, except that A has sufficient funds to pay B in country Z, where no such permission requirement exists. A may not rely on the refusal of the permission by the authorities of country X as an excuse for not paying B.

## SECTION 2: HARDSHIP

### ARTICLE 6.2.1

*(Contract to be observed)*

**Where the performance of a contract becomes more onerous for one of the parties, that party is nevertheless bound to perform its obligations subject to the following provisions on hardship.**

#### COMMENT

##### **1. Binding character of the contract the general rule**

The purpose of this Article is to make it clear that as a consequence of the general principle of the binding character of the contract (see Article 1.3) performance must be rendered as long as it is possible and regardless of the burden it may impose on the performing party. In other words, even if a party experiences heavy losses instead of the expected profits or the performance has become meaningless for that party the terms of the contract must nevertheless be respected.

#### Illustration

A, a forwarding agent, enters into a two-year shipping contract with B, a carrier. Under the contract B is bound to ship certain goods from country X to country Y at a fixed rate, on a monthly basis throughout the two-year period. Two years later, alleging a substantial increase in the price of fuel in the aftermath of a political crisis in the region, B requests a five per cent increase in the rate. B is not entitled to such an increase because B bears the risk of its performance becoming more onerous.

##### **2. Change in circumstances relevant only in exceptional cases**

The principle of the binding character of the contract is not however an absolute one. When supervening circumstances are such that they lead to a fundamental alteration of the equilibrium of the contract, they create an exceptional situation referred to in the Principles as “hardship” and dealt with in the following Articles of this Section.



The phenomenon of hardship has been acknowledged by various legal systems under the guise of other concepts such as frustration of purpose, *Wegfall der Geschäftsgrundlage*, *imprévision*, *eccessiva onerosità sopravvenuta*, etc. The term “hardship” was chosen because it is widely known in international trade practice as confirmed by the inclusion in many international contracts of so-called “hardship clauses”.

#### ARTICLE 6.2.2

*(Definition of hardship)*

**There is hardship where the occurrence of events fundamentally alters the equilibrium of the contract either because the cost of a party's performance has increased or because the value of the performance a party receives has diminished, and**

**(a) the events occur or become known to the disadvantaged party after the conclusion of the contract;**

**(b) the events could not reasonably have been taken into account by the disadvantaged party at the time of the conclusion of the contract;**

**(c) the events are beyond the control of the disadvantaged party; and**

**(d) the risk of the events was not assumed by the disadvantaged party.**

#### COMMENT

##### 1. Hardship defined

This Article defines hardship as a situation where the occurrence of events fundamentally alters the equilibrium of the contract, provided that those events meet the requirements which are laid down in subparagraphs (a) to (d).

##### 2. Fundamental alteration of equilibrium of the contract

Since the general principle is that a change in circumstances does not affect the obligation to perform (see Article 6.2.1), it follows that

hardship may not be invoked unless the alteration of the equilibrium of the contract is fundamental. Whether an alteration is “fundamental” in a given case will of course depend upon the circumstances.

### Illustration

1. In September 1989 A, a dealer in electronic goods situated in the former German Democratic Republic, purchases stocks from B, situated in country X, also a former socialist country. The goods are to be delivered by B in December 1990. In November 1990, A informs B that the goods are no longer of any use to it, claiming that after the unification of the German Democratic Republic and the Federal Republic of Germany and the opening of the former German Democratic Republic to the international market there is no longer any market for such goods imported from country X. Unless the circumstances indicate otherwise, A is entitled to invoke hardship.

#### *a. Increase in cost of performance*

In practice a fundamental alteration in the equilibrium of the contract may manifest itself in two different but related ways. The first is characterised by a substantial increase in the cost for one party of performing its obligation. This party will normally be the one who is to perform the non-monetary obligation. The substantial increase in the cost may, for instance, be due to a dramatic rise in the price of the raw materials necessary for the production of the goods or the rendering of the services, or to the introduction of new safety regulations requiring far more expensive production procedures.

#### *b. Decrease in value of the performance received by one party*

The second manifestation of hardship is characterised by a substantial decrease in the value of the performance received by one party, including cases where the performance no longer has any value at all for the receiving party. The performance may relate either to a monetary or a non-monetary obligation. The substantial decrease in the value or the total loss of any value of the performance may be due either to drastic changes in market conditions (e.g. the effect of a dramatic increase in inflation on a contractually agreed price) or the frustration of the purpose for which the performance was required (e.g. the effect of a prohibition to build on a plot of land acquired for building purposes or the effect of an export embargo on goods acquired with a view to their subsequent export).

Naturally the decrease in value of the performance must be capable of objective measurement: a mere change in the personal opinion of the receiving party as to the value of the performance is of no relevance. As

to the frustration of the purpose of the performance, this can only be taken into account when the purpose in question was known or at least ought to have been known to both parties.

### 3. Additional requirements for hardship to arise

#### *a. Events occur or become known after conclusion of the contract*

According to sub-paragraph (a) of this Article, the events causing hardship must take place or become known to the disadvantaged party after the conclusion of the contract. If that party had known of those events when entering into the contract, it would have been able to take them into account at that time. In such a case that party may not subsequently rely on hardship.

#### *b. Events could not reasonably have been taken into account by disadvantaged party*

Even if the change in circumstances occurs after the conclusion of the contract, sub-paragraph (b) of this Article makes it clear that such circumstances cannot cause hardship if they could reasonably have been taken into account by the disadvantaged party at the time the contract was concluded.

#### Illustration

2. A agrees to supply B with crude oil from country X at a fixed price for the next five years, notwithstanding the acute political tensions in the region. Two years after the conclusion of the contract, a war erupts between contending factions in neighbouring countries. The war results in a world energy crisis and oil prices increase drastically. A is not entitled to invoke hardship because such a rise in the price of crude oil was not unforeseeable.

Sometimes the change in circumstances is gradual, but the final result of those gradual changes may constitute a case of hardship. If the change began before the contract was concluded, hardship will not arise unless the pace of change increases dramatically during the life of the contract.

#### Illustration

3. In a sales contract between A and B the price is expressed in the currency of country X, a currency the value of which was already depreciating slowly against other major currencies before the conclusion of the contract. One month thereafter a political crisis in country X leads to a massive devaluation of its currency of the order

of 80%. Unless the circumstances indicate otherwise, this constitutes a case of hardship, since such a dramatic acceleration of the loss of value of the currency of country X was not foreseeable.

*c. Events beyond the control of disadvantaged party*

Under sub-paragraph (c) of this Article a case of hardship can only arise if the events causing the hardship are beyond the control of the disadvantaged party.

*d. Risks must not have been assumed by disadvantaged party*

Under sub-paragraph (d) there can be no hardship if the disadvantaged party had assumed the risk of the change in circumstances. The word “assumption” makes it clear that the risks need not have been taken over expressly, but that this may follow from the very nature of the contract. A party who enters into a speculative transaction is deemed to accept a certain degree of risk, even though it may not have been fully aware of that risk at the time it entered into the contract.

**Illustration**

4. A, an insurance company specialised in the insurance of shipping risks, requests an additional premium from those of its customers who have contracts which include the risks of war and civil insurrection, so as to meet the substantially greater risk to which it is exposed following upon the simultaneous outbreak of war and civil insurrection in three countries in the same region. A is not entitled to such an adaptation of the contract, since by the war and civil insurrection clauses insurance companies assume these risks even if three countries are affected at the same time.

**4. Hardship relevant only to performance not yet rendered**

By its very nature hardship can only become of relevance with respect to performances still to be rendered: once a party has performed, it is no longer entitled to invoke a substantial increase in the costs of its performance or a substantial decrease in the value of the performance it receives as a consequence of a change in circumstances which occurs after such performance.

If the fundamental alteration in the equilibrium of the contract occurs at a time when performance has been only partially rendered, hardship can be of relevance only to the parts of the performance still to be rendered.

**Illustration**

5. A enters into a contract with B, a waste disposal company in country X, for the purpose of arranging the storage of its waste. The contract provides for a four-year term and a fixed price per ton of waste. Two years after the conclusion of the contract, the environmental movement in country X gains ground and the Government of country X prescribes prices for storing waste which are ten times higher than before. B may successfully invoke hardship only with respect to the two remaining years of the life of the contract.

**5. Hardship normally relevant to long-term contracts**

Although this Article does not expressly exclude the possibility of hardship being invoked in respect of other kinds of contract, hardship will normally be of relevance to long-term contracts, i.e. those where the performance of at least one party extends over a certain period of time.

**6. Hardship and force majeure**

In view of the definitions of hardship in this Article and force majeure in Article 7.1.7, under the Principles there may be factual situations which can at the same time be considered as cases of hardship and of force majeure. If this is the case, it is for the party affected by these events to decide which remedy to pursue. If it invokes force majeure, it is with a view to its non-performance being excused. If, on the other hand, a party invokes hardship, this is in the first instance for the purpose of renegotiating the terms of the contract so as to allow the contract to be kept alive although on revised terms.

**7. Hardship and contract practice**

The definition of hardship in this Article is necessarily of a rather general character. International commercial contracts often contain much more precise and elaborate provisions in this regard. The parties may therefore find it appropriate to adapt the content of this Article so as to take account of the particular features of the specific transaction.

**ARTICLE 6.2.3***(Effects of hardship)*

**(1) In case of hardship the disadvantaged party is entitled to request renegotiations. The request shall be made without undue delay and shall indicate the grounds on which it is based.**

**(2) The request for renegotiation does not in itself entitle the disadvantaged party to withhold performance.**

**(3) Upon failure to reach agreement within a reasonable time either party may resort to the court.**

**(4) If the court finds hardship it may, if reasonable,**

**(a) terminate the contract at a date and on terms to be fixed, or**

**(b) adapt the contract with a view to restoring its equilibrium.**

**COMMENT****1. Disadvantaged party entitled to request renegotiations**

Since hardship consists in a fundamental alteration of the equilibrium of the contract, paragraph (1) of this Article in the first instance entitles the disadvantaged party to request the other party to enter into renegotiation of the original terms of the contract with a view to adapting them to the changed circumstances.

**Illustration**

1. A, a construction company situated in country X, enters into a lump sum contract with B, a governmental agency, for the erection of a plant in country Y. Most of the sophisticated machinery has to be imported from abroad. Due to an unexpected devaluation of the currency of country Y, which is the currency of payment, the cost of the machinery increases dramatically. A is entitled to request B to renegotiate the original contract price so as to adapt it to the changed circumstances.

A request for renegotiations is not admissible where the contract itself already incorporates a clause providing for the automatic adaptation of the contract (e.g. a clause providing for automatic indexation of the price if certain events occur).

#### Illustration

2. The facts are the same as in Illustration 1, except that the contract contains a price indexation clause relating to variations in the cost of materials and labour. A is not entitled to request a renegotiation of the price.

However, even in such a case renegotiation on account of hardship would not be precluded if the adaptation clause incorporated in the contract did not contemplate the events giving rise to hardship.

#### Illustration

3. The facts are the same as in Illustration 2, except that the substantial increase in A's costs is due to the adoption of new safety regulations in country Y. A is entitled to request B to renegotiate the original contract price so as to adapt it to the changed circumstances.

## 2. Request for renegotiations without undue delay

The request for renegotiations must be made as quickly as possible after the time at which hardship is alleged to have occurred (paragraph (1)). The precise time for requesting renegotiations will depend upon the circumstances of the case: it may, for instance, be longer when the change in circumstances takes place gradually (see Comment 3(b) on Article 6.2.2).

The disadvantaged party does not lose its right to request renegotiations simply because it fails to act without undue delay. The delay in making the request may however affect the finding as to whether hardship actually existed and, if so, its consequences for the contract.

## 3. Grounds for request for renegotiations

Paragraph (1) of this Article also imposes on the disadvantaged party a duty to indicate the grounds on which the request for renegotiations is based, so as to permit the other party better to assess whether or not the request for renegotiations is justified. An incomplete request is to be considered as not being raised in time, unless the grounds of the alleged hardship are so obvious that they need not be spelt out in the request.

Failure to set forth the grounds on which the request for renegotiations is based may have similar effects to those resulting from undue delay in making the request (see Comment 2 on this Article).

#### **4. Request for renegotiations and withholding of performance**

Paragraph (2) of this Article provides that the request for renegotiations does not of itself entitle the disadvantaged party to withhold performance. The reason for this lies in the exceptional character of hardship and in the risk of possible abuses of the remedy. Withholding performance may be justified only in extraordinary circumstances.

##### **Illustration**

4. A enters into a contract with B for the construction of a plant. The plant is to be built in country X, which adopts new safety regulations after the conclusion of the contract. The new regulations require additional apparatus and thereby fundamentally alter the equilibrium of the contract making A's performance substantially more onerous. A is entitled to request renegotiations and may withhold performance in view of the time it needs to implement the new safety regulations, but it may also withhold the delivery of the additional apparatus, for as long as the corresponding price adaptation is not agreed.

#### **5. Renegotiations in good faith**

Although nothing is said in this Article to that effect, both the request for renegotiations by the disadvantaged party and the conduct of both parties during the renegotiation process are subject to the general principle of good faith and fair dealing (see Article 1.7) and to the duty of cooperation (see Article 5.1.3). Thus the disadvantaged party must honestly believe that a case of hardship actually exists and not request renegotiations as a purely tactical manoeuvre. Similarly, once the request has been made, both parties must conduct the renegotiations in a constructive manner, in particular by refraining from any form of obstruction and by providing all the necessary information.

#### **6. Resort to the court upon failure to reach an agreement**

If the parties fail to reach agreement on the adaptation of the contract to the changed circumstances within a reasonable time, paragraph (3) of this Article authorises either party to resort to the court. Such a situation may arise either because the non-disadvantaged party completely ignored the request for renegotiations or because the renegotiations,



although conducted by both parties in good faith, did not have a positive outcome.

How long a party must wait before resorting to the court will depend on the complexity of the issues to be settled and the particular circumstances of the case.

## 7. Court measures in case of hardship

According to paragraph (4) of this Article a court which finds that a hardship situation exists may react in a number of different ways.

A first possibility is for it to terminate the contract. However, since termination in this case does not depend on non-performance by one of the parties, its effects on the performances already rendered might be different from those provided for by the rules governing termination in general (see Articles 7.3.1. *et seq.*). Accordingly, paragraph (4)(a) provides that termination shall take place “at a date and on terms to be fixed” by the court.

Another possibility would be for a court to adapt the contract with a view to restoring its equilibrium (paragraph (4)(b)). In so doing the court will seek to make a fair distribution of the losses between the parties. This may or may not, depending on the nature of the hardship, involve a price adaptation. However, if it does, the adaptation will not necessarily reflect in full the loss entailed by the change in circumstances, since the court will, for instance, have to consider the extent to which one of the parties has taken a risk and the extent to which the party entitled to receive a performance may still benefit from that performance.

Paragraph (4) of this Article expressly states that the court may terminate or adapt the contract only when this is reasonable. The circumstances may even be such that neither termination nor adaptation is appropriate and in consequence the only reasonable solution will be for the court either to direct the parties to resume negotiations with a view to reaching agreement on the adaptation of the contract, or to confirm the terms of the contract as they stand.

### Illustration

5. A, an exporter, undertakes to supply B, an importer in country X, with beer for three years. Two years after the conclusion of the contract new legislation is introduced in country X prohibiting the sale and consumption of alcoholic drinks. B immediately invokes hardship and requests A to renegotiate the contract. A recognises that hardship has occurred, but refuses to accept the modifications of the contract proposed by B. After one month of fruitless discussions B resorts to the court.

If B has the possibility to sell the beer in a neighbouring country, although at a substantially lower price, the court may decide to uphold the contract but to reduce the agreed price.

If on the contrary B has no such possibility, it may be reasonable for the court to terminate the contract, at the same time however requiring B to pay A for the last consignment still en route.

## CHAPTER 7

### NON-PERFORMANCE

#### SECTION 1: NON-PERFORMANCE IN GENERAL

##### ARTICLE 7.1.1

*(Non-performance defined)*

**Non-performance is failure by a party to perform any of its obligations under the contract, including defective performance or late performance.**

##### COMMENT

This Article defines “non-performance” for the purpose of the Principles. Particular attention should be drawn to two features of the definition.

The first is that “non-performance” is defined so as to include all forms of defective performance as well as complete failure to perform. Thus, it is non-performance for a builder to erect a building which is partly in accordance with the contract and partly defective or to complete the building late.

The second feature is that for the purposes of the Principles the concept of “non-performance” includes both non-excused and excused non-performance.

Non-performance may be excused by reason of the conduct of the other party to the contract (see Articles 7.1.2 (*Interference by the other party*) and 7.1.3 (*Withholding performance*) and Comments) or because of unexpected external events (see Article 7.1.7 (*Force majeure*) and Comment)). A party is not entitled to claim damages or specific performance for an excused non-performance of the other party but a party who has not received performance will as a rule be entitled to terminate the contract whether or not the non-performance is excused (see Article 7.3.1 *et seq.* and Comment).

There is no general provision dealing with cumulation of remedies. The assumption underlying the Principles is that all remedies which are not logically inconsistent may be cumulated. So, in general, a party who successfully insists on performance will not be entitled to damages but there is no reason why a party may not terminate a contract for non-excused non-performance and simultaneously claim damages (see Articles 7.2.5 (*Change of remedy*), 7.3.5 (*Effects of termination in general*) and 7.4.1 (*Right to damages*)).

#### ARTICLE 7.1.2

*(Interference by the other party)*

**A party may not rely on the non-performance of the other party to the extent that such non-performance was caused by the first party's act or omission or by another event for which the first party bears the risk.**

#### COMMENT

##### **1. Non-performance caused by act or omission of the party alleging non-performance**

This Article can be regarded as providing two excuses for non-performance. However conceptually, it goes further than this. When the Article applies, the relevant conduct does not become excused non-performance but loses the quality of non-performance altogether. It follows, for instance, that the other party will not be able to terminate for non-performance.

Two distinct situations are contemplated. In the first, one party is unable to perform either wholly or in part because the other party has done something which makes performance in whole or in part impossible.

#### Illustration

1. A agrees to perform building work on B's land beginning on 1 February. If B locks the gate to the land and does not allow A entry, B cannot complain that A has failed to begin work. B's conduct will often amount to non-excused non-performance either because of an express provision entitling A to access the land or because B's conduct infringes the obligations of good faith and co-operation.

This result does not however depend on B's non-performance being non-excused. The result will be the same where B's non-performance is excused, for instance because access to the land is barred by strikers.

The Principles contemplate the possibility that one party's interference result only in a partial impediment to performance by the other party. In such cases it will be necessary to decide the extent to which non-performance was caused by the first party's interference and that to which it was caused by other factors.

## **2. Non-performance caused by event for which party alleging non-performance bears the risk**

Another possibility is that non-performance may result from an event the risk of which is expressly or impliedly allocated by the contract to the party alleging non-performance.

### **Illustration**

2. A, a builder, concludes a construction contract to be performed on the premises of B, who already has many buildings on those premises which are the subject of an insurance policy covering any damage to the buildings. If the parties agree that the risk of accidental damage is to fall on B as the person insured, there would normally be no reason to reject the parties' allocation of risk since risks of this kind are normally covered by insurance. Even therefore if a fire were to be caused by A's negligence, the risk may be allocated to B, although it would clearly need more explicit language to carry this result than would be the case if the fire which destroyed the building were the fault of neither party.

## **ARTICLE 7.1.3**

*(Withholding performance)*

**(1) Where the parties are to perform simultaneously, either party may withhold performance until the other party tenders its performance.**

**(2) Where the parties are to perform consecutively, the party that is to perform later may withhold its performance until the first party has performed.**

## COMMENT

This Article must be read together with Article 6.1.4 (*Order of performance*). This Article is concerned with remedies and corresponds in effect to the civil law concept of *exceptio non adimpleti contractus*.

## Illustration

A agrees to sell B a thousand tons of white wheat, payment to be made by confirmed letter of credit opened on a bank from country X. A is not obliged to ship the goods unless and until B opens the letter of credit in conformity with its contractual obligations.

The text does not explicitly address the question which arises where one party performs in part but does not perform completely. In such a case the party entitled to receive performance may be entitled to withhold performance but only where in normal circumstances this is consonant with good faith and fair dealing (see Article 1.7).

## ARTICLE 7.1.4

(Cure by non-performing party)

**(1) The non-performing party may, at its own expense, cure any non-performance, provided that**

**(a) without undue delay, it gives notice indicating the proposed manner and timing of the cure;**

**(b) cure is appropriate in the circumstances;**

**(c) the aggrieved party has no legitimate interest in refusing cure; and**

**(d) cure is effected promptly.**

**(2) The right to cure is not precluded by notice of termination.**

**(3) Upon effective notice of cure, rights of the aggrieved party that are inconsistent with the non-performing party's performance are suspended until the time for cure has expired.**

**(4) The aggrieved party may withhold performance pending cure.**

**(5) Notwithstanding cure, the aggrieved party retains the right to claim damages for delay as well as for any harm caused or not prevented by the cure.**

## COMMENT

### 1. General principle

Paragraph (1) of this Article provides that, if certain conditions are met, the non-performing party may cure by correcting the non-performance. In effect, by meeting these conditions, the non-performing party is able to extend the time for performance for a brief period beyond that stipulated in the contract, unless timely performance is required by the agreement or the circumstances. This Article thus favours the preservation of the contract. It also reflects the policy of minimising economic waste, as incorporated in Article 7.4.8 (*Mitigation of harm*), and the basic principle of good faith stated in Article 1.7. This Article is related to the cure provisions contained in Articles 37 and 48 CISG and in some domestic laws governing contracts and sales. Even many of those legal systems that do not have a rule permitting cure would normally take a reasonable offer of cure into account in assessing damages.

### 2. Notice of cure

Cure may be effected only after the non-performing party gives notice of cure. The notice must be reasonable with regard to its timing and content as well as to the manner in which it is communicated. Notice of cure must be given without undue delay after the non-performing party learns of the non-performance. To the extent information is then available, the notice must indicate how cure is to be effected and when. Notice must also be communicated to the aggrieved party in a manner that is reasonable in the circumstances.

Notice of cure is considered to be “effective” when the requirements of paragraph (1)(a) - (c) have been met.

### 3. Appropriateness of cure

Whether cure is appropriate in the circumstances depends on whether it is reasonable, given the nature of the contract, to permit the non-performing party to make another attempt at performance. As indicated in paragraph (2), cure is not precluded merely because the failure to perform amounts to a fundamental non-performance. The factors to be

considered in determining the appropriateness of cure include whether the proposed cure promises to be successful in resolving the problem and whether the necessary or probable delay in effecting cure would be unreasonable or would itself constitute a fundamental non-performance. However, the right to cure is not defeated by the fact that the aggrieved party subsequently changes its position. If the non-performing party gives effective notice of cure, the aggrieved party's right to change position is suspended. Nonetheless, the situation may be different if the aggrieved party has changed position before receiving notice of cure.

#### **4. The aggrieved party's interest**

The non-performing party may not cure if the aggrieved party can demonstrate a legitimate interest in refusing cure. However, if notice of cure is properly given and if cure is appropriate in the circumstances, it is presumed that the non-performing party should be permitted to cure. A legitimate interest may arise, for example, if it is likely that, when attempting cure, the non-performing party will cause damage to person or property. On the other hand, a legitimate interest is not present if, on the basis of the non-performance, the aggrieved party has simply decided that it does not wish to continue contractual relations.

#### **Illustration**

1. A agrees to construct a road on B's property. When the road is complete, B discovers that the road grade is steeper than the contract permits. B also discovers that, during construction, A's trucks caused damage to B's timber. A gives notice of cure to regrade the road. Even if cure would otherwise be appropriate in the circumstances, B's desire to prevent further damage to the timber may provide a legitimate interest for refusing cure.

#### **5. Timing of cure**

Cure must be effected promptly after notice of cure is given. Time is of the essence in the exercise of the right to cure. The non-performing party is not permitted to lock the aggrieved party into an extended waiting period. The lack of inconvenience on the part of the aggrieved party does not justify the non-performing party in delaying cure.

#### **6. Proper forms of cure**

Cure may include repair and replacement as well as any other activities that remedy the non-performance and give to the aggrieved party all that it is entitled to expect under the contract. Repairs constitute cure only when they leave no evidence of the prior non-performance



and do not threaten the value or the quality of the product as a whole. It is left to the courts to determine the number of times the non-performing party may attempt a cure.

#### Illustration

2. A agrees to install an assembly line for high temperature enamel painting in B's factory. The motors are installed with insufficient lubricant and as a result "lock up" after a few hours of operation. A replaces the motors in a timely fashion, but refuses to examine and test the rest of the equipment to ensure that other parts of the line have not been damaged. A has not effectively cured.

### 7. Suspension of other remedies

When the non-performing party has given effective notice of cure, the aggrieved party may, in accordance with paragraph (4), withhold its own performance but, pursuant to paragraph (3), may not exercise any remedies inconsistent with the non-performing party's right to cure until it becomes clear that a timely and proper cure has not been or will not be effected. Inconsistent remedies include giving notice of termination, entering into replacement transactions and seeking damages or restitution.

### 8. Effect of a notice of termination

If the aggrieved party has rightfully terminated the contract pursuant to Articles 7.3.1(1) and 7.3.2(1), the effects of termination (see Articles 7.3.5, 7.3.6 and 7.3.7) are also suspended by an effective notice of cure. If the non-performance is cured, the notice of termination is inoperative. On the other hand, termination takes effect if the time for cure has expired and any fundamental non-performance has not been cured.

### 9. Right of aggrieved party to damages

Under paragraph (5) of this Article, even a non-performing party who successfully cures is liable for any harm that, before cure, was occasioned by the non-performance, as well as for any additional harm caused by the cure itself or by the delay or for any harm which the cure does not prevent. The principle of full compensation for damage suffered, as provided in Article 7.4.2, is fundamental to the Principles.

**10. The aggrieved party's obligations**

The decision to invoke this Article rests on the non-performing party. Once the aggrieved party receives effective notice of cure, it must permit cure and, as provided in Article 5.1.3, cooperate with the non-performing party. For example, the aggrieved party must permit any inspection that is reasonably necessary for the non-performing party to effect cure. If the aggrieved party refuses to permit cure when required to do so, any notice of termination is ineffective. Moreover, the aggrieved party may not seek remedies for any non-performance that could have been cured.

**Illustration**

3. A agrees to construct a shed on B's property in order to protect B's machinery from the weather. The roof is constructed in a defective manner. During a storm, water leaks into the shed and B's machinery is damaged. B gives notice of termination. A gives timely notice of cure. B does not wish to deal further with A and refuses the cure. If cure is appropriate in the circumstances and the other conditions for cure are met, B cannot invoke remedies for the faulty construction but can recover for damage caused to the machinery before the cure was to be effected. If cure is inappropriate in the circumstances, or if the proposed cure would not have solved the problem, the contract is terminated by B's notice.

**ARTICLE 7.1.5**

*(Additional period for performance)*

**(1) In a case of non-performance the aggrieved party may by notice to the other party allow an additional period of time for performance.**

**(2) During the additional period the aggrieved party may withhold performance of its own reciprocal obligations and may claim damages but may not resort to any other remedy. If it receives notice from the other party that the latter will not perform within that period, or if upon expiry of that period due performance has not been made, the aggrieved party may resort to any of the remedies that may be available under this Chapter.**

**(3) Where in a case of delay in performance which is not fundamental the aggrieved party has given notice allowing an additional period of time of reasonable length, it may terminate the contract at the end of that period. If the additional period allowed is not of reasonable length it shall be extended to a reasonable length. The aggrieved party may in its notice provide that if the other party fails to perform within the period allowed by the notice the contract shall automatically terminate.**

**(4) Paragraph (3) does not apply where the obligation which has not been performed is only a minor part of the contractual obligation of the non-performing party.**

#### COMMENT

This Article deals with the situation where one party performs late and the other party is willing to give extra time for performance. It is inspired by the German concept of *Nachfrist* although similar results are obtained by different conceptual means in other legal systems.

#### 1. Special characteristics of late performance

The Article recognises that late performance is significantly different from other forms of defective performance. Late performance can never be remedied since once the date for performance has passed it will not occur again, but nevertheless in many cases the party who is entitled to performance will much prefer even a late performance to no performance at all. Secondly, at the moment when a party fails to perform on time it is often unclear how late performance will in fact be. The commercial interest of the party receiving performance may often therefore be that a reasonably speedy completion, although late, will be perfectly acceptable but that a long delayed completion will not. The procedure enables that party to give the performing party a second chance without prejudicing its other remedies.

**2. Effects of granting extension of time for performance**

The party who grants the extension of time cannot terminate or seek specific performance during the extension time. The right to recover damages arising from late performance is not affected.

The position at the end of the period of extension depends on whether the late performance was already fundamental at the time when the extension was granted. In this situation, if the contract is not completely performed during the extension, the right to terminate for fundamental non-performance simply springs into life again as soon as the extension period expires. On the other hand, if the late performance was not yet fundamental, termination would only be possible at the end of the period of extension if the extension was reasonable in length.

**Illustrations**

1. A agrees to construct a special bullet-proof body for B's Mercedes. The contract provides that the body is to be finished by 1 February so that the car can be shipped to B's country of residence. On 31 January the car is needed but not yet quite finished. A assures B that it will be able to complete the work if given another week and B agrees to a week's extension of time. If the car is finished within the week B must accept it but may recover any damages, for example extra shipping charges. If the work is not finished within the week, B may refuse to accept delivery and terminate the contract.
2. A, a company in country X, concludes a contract with B, a company in country Y, to build 100 km. of motorway in the latter country. The contract provides that the motorway will be finished within two years from the start of the work. After two years, A has in fact built 85 km. and it is clear that it will take at least three more months to finish the motorway. B gives A notice to complete within a further month. B is not entitled to terminate at the end of the month because the additional period of time is not reasonable; it shall be extended to the reasonable period of three months.

**ARTICLE 7.1.6**  
*(Exemption clauses)*

**A clause which limits or excludes one party's liability for non-performance or which permits one party to render performance substantially different from what the other party reasonably expected may not be invoked if it would be grossly unfair to do so, having regard to the purpose of the contract.**

**COMMENT**

**1. The need for a special rule on exemption clauses**

The Principles contain no general rule permitting a court to strike down abusive or unconscionable contract terms. Apart from the principle of good faith and fair dealing (see Article 1.7) which may exceptionally be invoked in this respect, there is only one provision permitting the avoidance at any time of the contract as a whole as well as of any of its individual terms when they unjustifiably give one party an excessive advantage (see Article 3.2.7).

The reason for the inclusion of a specific provision on exemption clauses is that they are particularly common in international contract practice and tend to give rise to much controversy between the parties.

Ultimately, this Article has opted in favour of a rule which gives the court a broad discretionary power based on the principle of fairness. Terms regulating the consequences of non-performance are in principle valid but the court may ignore clauses which are grossly unfair.

**2. "Exemption clauses" defined**

For the purpose of this Article exemption clauses are in the first instance those terms which directly limit or exclude the non-performing party's liability in the event of non-performance. Such clauses may be expressed in different ways (e.g. fixed sum, ceiling, percentage of the performance in question, deposit retained).

Exemption clauses are further considered to be those which permit a party to render a performance substantially different from what the other party reasonably expected. In practice clauses of this kind are in particular those the purpose or effect of which is to allow the performing party unilaterally to alter the character of the performance

promised in such a way as to transform the contract. Such clauses are to be distinguished from those which are limited to defining the performance undertaken by the party in question.

### **Illustrations**

1. A tour operator offers at a high price a tour providing for accommodation in specifically designated luxury hotels. A term of the contract provides that the operator may alter the accommodation if the circumstances so require. If the operator puts up its clients in second class hotels, it will be liable to them notwithstanding the contractual term since the clients expected to be accommodated in hotels of a category similar to that which had been promised.
2. A hotelkeeper exhibits a notice to the effect that the hotel is responsible for cars left in the garage but not for objects contained in the cars. This term is not an exemption clause for the purpose of this Article since its purpose is merely that of defining the scope of the hotelkeeper's obligation.

### **3. Exemption clauses to be distinguished from forfeiture clauses**

Exemption clauses are to be distinguished from forfeiture clauses which permit a party to withdraw from a contract on payment of an indemnity. In practice, however, there may be forfeiture clauses which are in reality intended by the parties to operate as disguised exemption clauses.

### **4. Exemption clauses and agreed payment for non-performance**

A contract term providing that a party who does not perform is to pay a specified sum to the aggrieved party for such non-performance (see Article 7.4.13) may also have the effect of limiting the compensation due to the aggrieved party. In such cases the non-performing party may not be entitled to rely on the term in question if the conditions laid down in this Article are satisfied.

### **Illustration**

3. A enters into a contract with B for the building of a factory. The contract contains a penalty clause providing for payment of Australian dollars (AUD) 10,000 for each week of delay. The work is not completed within the agreed period because A deliberately suspends the work for another project which was more lucrative for it and in respect of which the penalty for delay was higher. The actual harm suffered by B as a result of the delay amounts to AUD

20,000 per week. A is not entitled to rely on the penalty clause and B may recover full compensation of the actual harm sustained, as the enforcement of that clause would in the circumstances be grossly unfair in view of A's deliberate non-performance.

## 5. Cases where exemption clauses may not be relied upon

Following the approach adopted in most national legal systems, this Article starts out from the assumption that in application of the doctrine of freedom of contract (see Article 1.1) exemption clauses are in principle valid. A party may not however invoke such a clause if it would be grossly unfair to do so.

This will above all be the case where the term is inherently unfair and its application would lead to an evident imbalance between the performances of the parties. Moreover, there may be circumstances in which even a term that is not in itself manifestly unfair may not be relied upon: for instance, where the non-performance is the result of grossly negligent conduct or where the aggrieved party could not have obviated the consequences of the limitation or exclusion of liability by taking out appropriate insurance.

In all cases regard must be had to the purpose of the contract and in particular to what a party could legitimately have expected from the performance of the contract.

### Illustrations

4. A, an accountant, undertakes to prepare B's accounts. The contract contains a term excluding any liability of A for the consequences arising from any inaccuracy whatsoever in A's performance of the contract. As a result of a serious mistake by A, B pays 100% more taxes than were due. A may not rely on the exemption clause which is inherently unfair.

5. A, a warehouse operator, enters into a contract with B for the surveillance of its premises. The contract contains a term limiting B's liability. Thefts occur in the terminal resulting in loss exceeding the amount of the limitation. Although the term, agreed upon by two professional parties, is not inherently unfair, it may not be relied upon by B if the thefts were committed by B's servants in the course of their employment.

**6. Consequence of inability to rely on exemption clauses**

If a party is not entitled to rely on an exemption clause, its liability is unaffected and the aggrieved party may obtain full compensation for the non-performance. Contrary to the rule laid down with respect to agreed payment for non-performance in Article 7.4.13, the court has no power to modify the exemption clause.

**ARTICLE 7.1.7**

*(Force majeure)*

**(1) Non-performance by a party is excused if that party proves that the non-performance was due to an impediment beyond its control and that it could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.**

**(2) When the impediment is only temporary, the excuse shall have effect for such period as is reasonable having regard to the effect of the impediment on the performance of the contract.**

**(3) The party who fails to perform must give notice to the other party of the impediment and its effect on its ability to perform. If the notice is not received by the other party within a reasonable time after the party who fails to perform knew or ought to have known of the impediment, it is liable for damages resulting from such non-receipt.**

**(4) Nothing in this Article prevents a party from exercising a right to terminate the contract or to withhold performance or request interest on money due.**

**COMMENT****1. The notion of force majeure**

This Article covers the ground covered in common law systems by the doctrines of frustration and impossibility of performance and in civil law systems by doctrines such as force majeure, *Unmöglichkeit*,



etc. but it is identical with none of these doctrines. The term “force majeure” was chosen because it is widely known in international trade practice, as confirmed by the inclusion in many international contracts of so-called “force majeure” clauses.

### Illustration

1. A, a manufacturer in country X, sells a nuclear power station to B, a utility company in country Y. Under the terms of the contract A undertakes to supply all the power station’s requirements of uranium for ten years at a price fixed for that period, expressed in US dollars and payable in New York. The following separate events occur:

(1) After five years the currency of country Y collapses to 1% of its value against the dollar at the time of the contract. B is not discharged from liability as the parties have allocated this risk by the payment provisions.

(2) After five years the Government of country Y imposes foreign exchange controls which prevent B paying in any currency other than that of country Y. B is excused from paying in US dollars. A is entitled to terminate the contract to supply uranium.

(3) After five years the world uranium market is cornered by a group of speculators. The price of uranium on the world market rises to ten times the contract figure. A is not excused from delivering uranium as this is a risk which was foreseeable at the time of making the contract.

## 2. Effects of force majeure on the rights and duties of the parties

The Article does not restrict the rights of the party who has not received performance to terminate if the non-performance is fundamental. What it does do, where it applies, is to excuse the non-performing party from liability in damages.

In some cases the impediment will prevent any performance at all but in many others it will simply delay performance and the effect of the Article will be to give extra time for performance. It should be noted that in this event the extra time may be greater (or less) than the length of the interruption because the crucial question will be what is the effect of the interruption on the progress of the contract.

### Illustration

2. A contracts to lay a natural gas pipeline across country X. Climatic conditions are such that it is normally impossible to work between 1 November and 31 March. The contract is timed to finish on 31 October but the start of work is delayed for a month by a civil war in a neighbouring country which makes it impossible to bring in all the piping on time. If the consequence is reasonably to prevent

the completion of the work until its resumption in the following spring, A may be entitled to an extension of five months even though the delay was itself of one month only.

### **3. Force majeure and hardship**

This Article must be read together with Chapter 6, Section 2 of the Principles dealing with hardship (see Comment 6 on Article 6.2.2).

### **4. Force majeure and contract practice**

The definition of force majeure in paragraph (1) of this Article is necessarily of a rather general character. International commercial contracts often contain much more precise and elaborate provisions in this regard. The parties may therefore find it appropriate to adapt the content of this Article so as to take account of the particular features of the specific transaction.

## SECTION 2: RIGHT TO PERFORMANCE

### ARTICLE 7.2.1

*(Performance of monetary obligation)*

**Where a party who is obliged to pay money does not do so, the other party may require payment.**

#### COMMENT

This Article reflects the generally accepted principle that payment of money which is due under a contractual obligation can always be demanded and, if the demand is not met, enforced by legal action before a court. The term “require” is used in this Article to cover both the demand addressed to the other party and the enforcement, whenever necessary, of such a demand by a court.

The Article applies irrespective of the currency in which payment is due or may be made. In other words, the right of the obligee to require payment extends also to cases of payment in a foreign currency. For the determination of the currency in which a monetary obligation is due or payment may be made, see Articles 6.1.9, 6.1.10 and 7.4.12.

Exceptionally, the right to require payment of the price of the goods or services to be delivered or rendered may be excluded. This is in particular the case where a usage requires a seller to resell goods which are neither accepted nor paid for by the buyer. For the applicability of usages, see Article 1.9.

### ARTICLE 7.2.2

*(Performance of non-monetary obligation)*

**Where a party who owes an obligation other than one to pay money does not perform, the other party may require performance, unless**

**(a) performance is impossible in law or in fact;**

**(b) performance or, where relevant, enforcement is unreasonably burdensome or expensive;**

(c) the party entitled to performance may reasonably obtain performance from another source;

(d) performance is of an exclusively personal character; or

(e) the party entitled to performance does not require performance within a reasonable time after it has, or ought to have, become aware of the non-performance.

## COMMENT

### 1. Right to require performance of non-monetary obligations

In accordance with the general principle of the binding character of the contract (see Article 1.3), each party should as a rule be entitled to require performance by the other party not only of monetary, but also of non-monetary obligations, assumed by that party. While this is not controversial in civil law countries, common law systems allow enforcement of non-monetary obligations only in special circumstances.

Following the basic approach of CISG (Article 46) this Article adopts the principle of specific performance, subject to certain qualifications.

The principle is particularly important with respect to contracts other than sales contracts. Unlike the obligation to deliver something, contractual obligations to do something or to abstain from doing something can often be performed only by the other contracting party itself. In such cases the only way of obtaining performance from a party who is unwilling to perform is by enforcement.

### 2. Remedy not discretionary

While CISG provides that “a court is not bound to enter a judgement for specific performance unless the court would do so under its own law in respect of similar contracts of sale not governed by [the] Convention” (Article 28), under the Principles specific performance is not a discretionary remedy, i.e. a court must order performance, unless one of the exceptions laid down in this Article applies.

### 3. Exceptions to the right to require performance

#### a. *Impossibility*

A performance which is impossible in law or in fact, cannot be required (sub-paragraph (a)). However, impossibility does not nullify a

contract: other remedies may be available to the aggrieved party (see Articles 3.1.3 and 7.1.7(4)).

The refusal of a public permission which is required under the applicable domestic law and which affects the validity of the contract renders the contract void (see Article 6.1.17(1)), with the consequence that the problem of enforceability of the performance cannot arise. When, however, the refusal merely renders the performance impossible without affecting the validity of the contract (see Article 6.1.17(2)), sub-paragraph (a) of this Article applies and performance cannot be required.

*b. Unreasonable burden*

In exceptional cases, particularly when there has been a drastic change of circumstances after the conclusion of a contract, performance, although still possible, may have become so onerous that it would run counter to the general principle of good faith and fair dealing (see Article 1.7) to require it.

*Illustration*

1. An oil tanker has sunk in coastal waters in a heavy storm. Although it would be possible to lift the ship from the bottom of the sea, the shipper may not require performance of the contract of carriage if this would involve the shipowner in expense vastly exceeding the value of the oil (see Article 7.2.2(b)).

The words “where relevant, enforcement” take account of the fact that in common law systems it is the courts and not the obligees who supervise the execution of orders for specific performance. As a consequence, in certain cases, especially those involving performances extended in time, courts in those countries refuse specific performance if supervision would impose undue burdens upon courts.

As to other possible consequences arising from drastic changes of circumstances amounting to a case of hardship, see Articles 6.2.1 *et seq.*

*c. Replacement transaction*

Many goods and services are of a standard kind, i.e. the same goods or services are offered by many suppliers. If a contract for such staple goods or standard services is not performed, most customers will not wish to waste time and effort extracting the contractual performance from the other party. Instead, they will go into the market, obtain substitute goods or services and claim damages for non-performance. In view of this economic reality sub-paragraph (c) excludes specific performance whenever the party entitled to performance may reasonably

obtain performance from another source. That party may terminate the contract and conclude a replacement transaction (see Article 7.4.5).

The word “reasonably” indicates that the mere fact that the same performance can be obtained from another source is not in itself sufficient, since the aggrieved party could not in certain circumstances reasonably be expected to have recourse to an alternative supplier.

#### Illustration

2. A, situated in a developing country where foreign exchange is scarce, buys a machine of a standard type from B, a manufacturer situated in country X, a developed country. In compliance with the contract, A pays the price of USD 100,000 before delivery. B does not deliver. Although A could obtain the machine from another source in country X, it would be unreasonable, in view of the scarcity and high price of foreign exchange in its home country, to require A to take this course. A is therefore entitled to require delivery of the machine from B.

#### *d. Performance of an exclusively personal character*

Where performance has an exclusively personal character, enforcement would interfere with the personal freedom of the obligor. Moreover, enforcement of performance often impairs its quality. The supervision of a very personal performance may also give rise to insuperable practical difficulties, as is shown by the experience of countries which have saddled their courts with this kind of responsibility. For all these reasons, sub-paragraph (d) excludes enforcement of performance of an exclusively personal character.

The precise scope of this exception depends essentially upon the meaning of the phrase “exclusively personal character”. The modern tendency is to confine this concept to performances of a unique character. The exception does not apply to obligations undertaken by a company. Nor are ordinary activities of a lawyer, a surgeon or an engineer covered by the phrase for they can be performed by other persons with the same training and experience. A performance is of an exclusively personal character if it is not delegable and requires individual skills of an artistic or scientific nature or if it involves a confidential and personal relationship.

## Illustrations

3. An undertaking by a firm of architects to design a row of ten buildings can be specifically enforced as the firm can delegate the task to one of the partners or employ an outside architect to perform it.
4. By contrast, an undertaking by a world-famous architect to design a new city hall embodying the idea of a city of the 21<sup>st</sup> century cannot be enforced because it is highly unique and calls for the exercise of very special skills.

The performance of obligations to abstain from doing something does not fall under sub-paragraph (d).

*e. Request within reasonable time*

Performance of a contract often requires special preparation and efforts by the obligor. If the time for performance has passed but the obligee has failed to demand performance within a reasonable time, the obligor may be entitled to assume that the obligee will not insist upon performance. If the obligee were to be allowed to leave the obligor in a state of uncertainty as to whether performance will be required, the risk might arise of the obligee's speculating unfairly, to the detriment of the obligor, upon a favourable development of the market.

For these reasons sub-paragraph (e) excludes the right to performance if it is not required within a reasonable time after the obligee has become, or ought to have become, aware of the non-performance.

For a similar rule concerning the loss of the right to terminate the contract, see Article 7.3.2(2).

**ARTICLE 7.2.3**

*(Repair and replacement of defective performance)*

**The right to performance includes in appropriate cases the right to require repair, replacement, or other cure of defective performance. The provisions of Articles 7.2.1 and 7.2.2 apply accordingly.**

**COMMENT****1. Right to performance in case of defective performance**

This Article applies the general principles of Articles 7.2.1 and 7.2.2 to a special, yet very frequent, case of non-performance, i.e. defective performance. For the sake of clarity the Article specifies that the right to require performance includes the right of the party who has received a defective performance to require cure of the defect.

**2. Cure of defective performance**

Under the Principles cure denotes the right both of the non-performing party to correct its performance (see Article 7.1.4) and of the aggrieved party to require such correction by the non-performing party. This Article deals with the latter right.

The Article expressly mentions two specific examples of cure, namely repair and replacement. Repairing defective goods (or making good an insufficient service) is the most common case and replacement of a defective performance is also frequent. The right to require repair or replacement may also exist with respect to the payment of money, for instance in case of an insufficient payment or of a payment in the wrong currency or to an account different from that agreed upon by the parties.

Apart from repair and replacement there are other forms of cure, such as the removal of the rights of third persons over goods or the obtaining of a necessary public permission.

**3. Restrictions**

The right to require cure of a defective performance is subject to the same limitations as the right to performance in general.

Most of the exceptions to the right to require performance that are set out in Article 7.2.2 are easily applicable to the various forms of cure of a defective performance. Only the application of sub-paragraph (b) calls for specific comment. In many cases involving small, insignificant defects, both replacement and repair may involve “unreasonable effort or expense” and are therefore excluded.

**Illustration**

A new car is sold which has a small painting defect which decreases the value of the car by 0.01 % of the purchase price. Repainting would cost 0.5% of the purchase price. A claim for repair is excluded but the buyer is entitled to require a reduction in the purchase price.



**ARTICLE 7.2.4**  
*(Judicial penalty)*

**(1) Where the court orders a party to perform, it may also direct that this party pay a penalty if it does not comply with the order.**

**(2) The penalty shall be paid to the aggrieved party unless mandatory provisions of the law of the forum provide otherwise. Payment of the penalty to the aggrieved party does not exclude any claim for damages.**

**COMMENT**

**1. Judicially imposed penalty**

Experience in some legal systems has shown that the threat of a judicially imposed penalty for disobedience is a most effective means of ensuring compliance with judgments ordering the performance of contractual obligations. Other systems, on the contrary, do not provide for such sanctions because they are considered to constitute an inadmissible encroachment upon personal freedom.

This Article takes a middle course by providing for monetary but not for other forms of penalty, applicable to all kinds of orders for performance including those for payment of money.

**2. Imposition of penalty at discretion of the court**

The use of the word “may” in paragraph (1) of this Article makes it clear that the imposition of a penalty is a matter of discretion for the court. Its exercise depends upon the kind of obligation to be performed. In the case of money judgments, a penalty should be imposed only in exceptional situations, especially where speedy payment is essential for the aggrieved party. The same is true for obligations to deliver goods. Obligations to pay money or to deliver goods can normally be easily enforced by ordinary means of execution. By contrast, in the case of obligations to do or to abstain from doing something, which moreover cannot easily be performed by a third person, enforcement by means of judicial penalties is often the most appropriate solution.

**3. Beneficiary**

Legal systems differ as to the question of whether judicial penalties should be paid to the aggrieved party, to the State, or to both. Some

systems regard payment to the aggrieved party as constituting an unjustified windfall benefit which is contrary to public policy.

While rejecting this latter view and indicating the aggrieved party as the beneficiary of the penalty, the first sentence of paragraph (2) of this Article expressly mentions the possibility of mandatory provisions of the law of the forum not permitting such a solution and indicating other possible beneficiaries of judicial penalties.

#### **4. Judicial penalties distinguished from damages and from agreed payment for non-performance**

The second sentence of paragraph (2) makes it clear that a judicial penalty paid to the aggrieved party does not affect its claim for damages. Payment of the penalty is regarded as compensating the aggrieved party for those disadvantages which cannot be taken into account under the ordinary rules for the recovery of damages. Moreover, since payment of damages will usually occur substantially later than payment of a judicial penalty, courts may to some degree be able, in measuring the damages, to take the payment of the penalty into account.

Judicial penalties are moreover to be distinguished from agreed payments for non-performance which are dealt with in Article 7.4.13, although the latter fulfil a function similar to that of the former. If the court considers that the contractual stipulation of the payment of a sum in case of non-performance already provides a sufficient incentive for performance, it may refuse to impose a judicial penalty.

#### **5. Form and procedure**

A judicial penalty may be imposed in the form of a lump sum payment or of a payment by instalments.

The procedure relating to the imposition of a judicial penalty is governed by the *lex fori*.

#### **6. Penalties imposed by arbitrators**

Since according to Article 1.11 “court” includes an arbitral tribunal, the question arises of whether arbitrators might also be allowed to impose a penalty.

While a majority of legal systems seems to deny such a power to arbitrators, some modern legislation and recent court practice have recognised it. This solution, which is in keeping with the increasingly important role of arbitration as an alternative means of dispute

resolution, especially in international commerce, is endorsed by the Principles. Since the execution of a penalty imposed by arbitrators can only be effected by, or with the assistance of, a court, appropriate supervision is available to prevent any possible abuse of the arbitrators' power.

## **7. Recognition and enforcement of decisions imposing penalties**

Attention must be drawn to the problems of recognition and enforcement, in countries other than the forum State, of judicial decisions and of arbitral awards imposing penalties. Special rules on this matter are sometimes to be found in national law and to some extent in international treaties.

### **ARTICLE 7.2.5**

*(Change of remedy)*

**(1) An aggrieved party who has required performance of a non-monetary obligation and who has not received performance within a period fixed or otherwise within a reasonable period of time may invoke any other remedy.**

**(2) Where the decision of a court for performance of a non-monetary obligation cannot be enforced, the aggrieved party may invoke any other remedy.**

## **COMMENT**

### **1. Aggrieved party entitled to change of remedy**

This Article addresses a problem which is peculiar to the right to require performance. The aggrieved party may abandon the remedy of requiring performance of a non-monetary obligation and opt instead for another remedy or remedies.

This choice is permitted on account of the difficulties usually involved in the enforcement of non-monetary obligations. Even if the aggrieved party first decides to invoke its right to require performance, it would not be fair to confine that party to this single option. The non-performing party may subsequently become unable to perform, or its inability may only become evident during the proceedings.

**2. Voluntary change of remedy**

Two situations must be addressed.

In the first case, the aggrieved party has required performance but changes its mind before execution of a judgment in its favour, perhaps because it has discovered the non-performing party's inability to perform. The aggrieved party now wishes to invoke one or more other remedies. Such a voluntary change of remedy can only be admitted if the interests of the non-performing party are duly protected. It may have prepared for performance, invested effort and incurred expense. For this reason paragraph (1) of this Article makes it clear that the aggrieved party is entitled to invoke another remedy only if it has not received performance within a fixed period or otherwise within a reasonable period of time.

How much additional time must be made available to the non-performing party for performance depends upon the difficulty which the performance involves. The non-performing party has the right to perform provided it does so before the expiry of the additional period.

For similar conditions which restrict the right of termination in case of delay in performance, see Article 7.3.2(2).

**3. Unenforceable decision**

Paragraph (2) addresses the second and less difficult case in which the aggrieved party has attempted without success to enforce a judicial decision or arbitral award directing the non-performing party to perform. In this situation it is obvious that the aggrieved party may immediately pursue other remedies.

**4. Time limits**

In the event of a subsequent change of remedy the time limit provided for a notice of termination under Article 7.3.2(2) must, of course, be extended accordingly. The reasonable time for giving notice begins to run, in the case of a voluntary change of remedy, after the aggrieved party has or ought to have become aware of the non-performance at the expiry of the additional period of time available to the non-performing party to perform; and in the case of paragraph (2) of this Article, it will begin to run after the aggrieved party has or ought to have become aware of the unenforceability of the decision or award requiring performance.

## **SECTION 3: TERMINATION**

### **ARTICLE 7.3.1**

*(Right to terminate the contract)*

**(1) A party may terminate the contract where the failure of the other party to perform an obligation under the contract amounts to a fundamental non-performance.**

**(2) In determining whether a failure to perform an obligation amounts to a fundamental non-performance regard shall be had, in particular, to whether**

**(a) the non-performance substantially deprives the aggrieved party of what it was entitled to expect under the contract unless the other party did not foresee and could not reasonably have foreseen such result;**

**(b) strict compliance with the obligation which has not been performed is of essence under the contract;**

**(c) the non-performance is intentional or reckless;**

**(d) the non-performance gives the aggrieved party reason to believe that it cannot rely on the other party's future performance;**

**(e) the non-performing party will suffer disproportionate loss as a result of the preparation or performance if the contract is terminated.**

**(3) In the case of delay the aggrieved party may also terminate the contract if the other party fails to perform before the time allowed it under Article 7.1.5 has expired.**

### **COMMENT**

#### **1. Termination even if non-performance is excused**

The rules set out in this Section are intended to apply both to cases where the non-performing party is liable for the non-performance and to those where the non-performance is excused so that the aggrieved party

can claim neither specific performance nor damages for non-performance.

### Illustration

1. A, a company located in country X, buys wine from B in country Y. The Government of country X subsequently imposes an embargo upon the import of agricultural products from country Y. Although the impediment cannot be attributed to A, B may terminate the contract.

### **2. Right to terminate the contract dependent on fundamental non-performance**

Whether in a case of non-performance by one party the other party should have the right to terminate the contract depends upon the weighing of a number of considerations. On the one hand, performance may be so late or so defective that the aggrieved party cannot use it for its intended purpose, or the behaviour of the non-performing party may in other respects be such that the aggrieved party should be permitted to terminate the contract.

On the other hand, termination will often cause serious detriment to the non-performing party whose expenses in preparing and tendering performance may not be recovered.

For these reasons paragraph (1) of this Article provides that an aggrieved party may terminate the contract only if the non-performance of the other party is “fundamental”, i.e. material and not merely of minor importance. See also Articles 7.3.3. and 7.3.4.

### **3. Circumstances of significance in determining whether non-performance is fundamental**

Paragraph (2) of this Article lists a number of circumstances which are relevant to the determination of whether, in a given case, failure to perform an obligation amounts to fundamental non-performance.

#### *a. Non-performance substantially depriving the other party of its expectations*

The first factor referred to in paragraph (2)(a) is that the non-performance is so fundamental that the aggrieved party is substantially deprived of what it was entitled to expect at the time of the conclusion of the contract.

## Illustration

2. On 1 May A contracts to deliver standard software before 15 May to B who has requested speedy delivery. If A tenders delivery on 15 June, B may refuse delivery and terminate the contract.

The aggrieved party cannot terminate the contract if the non-performing party can show that it did not foresee, and could not reasonably have foreseen, that the non-performance was fundamental for the other party.

## Illustration

3. A undertakes to remove waste from B's site within thirty days without specifying the exact date of commencement. B fails to inform A that B has hired excavators at high cost to begin work on the site on 2 January. B cannot terminate its contract with A on the ground that A had not cleared the site on 2 January.

*b. Strict performance of contract of essence*

Paragraph (2)(b) looks not at the actual gravity of the non-performance but at the nature of the contractual obligation for which strict performance might be of essence. Such obligations of strict performance are not uncommon in commercial contracts. For example, in contracts for the sale of commodities the time of delivery is normally considered to be of the essence, and in a documentary credit transaction the documents tendered must conform strictly to the terms of the credit.

*c. Intentional non-performance*

Paragraph (2)(c) deals with the situation where the non-performance is intentional or reckless. It may, however, be contrary to good faith (see Article 1.7) to terminate a contract if the non-performance, even though committed intentionally, is insignificant.

*d. No reliance on future performance*

Under paragraph (2)(d) the fact that non-performance gives the aggrieved party reason to believe that it cannot rely on the other party's future performance is of significance. If a party is to make its performance in instalments, and it is clear that a defect found in one of the earlier performances will be repeated in all performances, the aggrieved party may terminate the contract even if the defects in the early instalment would not of themselves justify termination.

Sometimes an intentional breach may show that a party cannot be trusted.

**Illustration**

4. A, the agent of B, who is entitled to reimbursement for expenses, submits false vouchers to B. Although the amounts claimed are insignificant, B may treat A's behaviour as a fundamental non-performance and terminate the agency contract.

**e. Disproportionate loss**

Paragraph (2)(e) deals with situations in which a party who fails to perform has relied on the contract and has prepared or tendered performance. In these cases regard is to be had to the extent to which that party suffers disproportionate loss if the non-performance is treated as fundamental. Non-performance is less likely to be treated as fundamental if it occurs late, after the preparation of performance, than if it occurs early before such preparation. Whether a performance tendered or rendered can be of any benefit to the non-performing party if it is refused or has to be returned to that party is also of relevance.

**Illustration**

5. On 1 May A undertakes to deliver software which is to be produced specifically for B. It is agreed that delivery shall be made before 31 December. A tenders delivery on 31 January, at which time B still needs the software, which A cannot sell to other users. B may claim damages from A, but cannot terminate the contract.

**4. Termination after *Nachfrist***

Paragraph (3) makes reference to Article 7.1.5, paragraph (3) of which provides that the aggrieved party may use the *Nachfrist* procedure to terminate a contract which may not otherwise be terminated in case of delay (see Comment 2 on Article 7.1.5).

**ARTICLE 7.3.2**

*(Notice of termination)*

**(1) The right of a party to terminate the contract is exercised by notice to the other party.**



**(2) If performance has been offered late or otherwise does not conform to the contract the aggrieved party will lose its right to terminate the contract unless it gives notice to the other party within a reasonable time after it has or ought to have become aware of the offer or of the non-conforming performance.**

## COMMENT

### 1. The requirement of notice

Paragraph (1) of this Article reaffirms the principle that the right of a party to terminate the contract is exercised by notice to the other party. The notice requirement will permit the non-performing party to avoid any loss due to uncertainty as to whether the aggrieved party will accept the performance. At the same time it prevents the aggrieved party from speculating on a rise or fall in the value of the performance to the detriment of the non-performing party.

### 2. Performance overdue

When performance is due but has not been made, the aggrieved party's course of action will depend upon its wishes and knowledge.

It may be the case that the aggrieved party does not know whether the other party intends to perform, and either no longer wants the performance or is undecided. In this case the aggrieved party may wait and see whether performance is ultimately tendered and make up its mind if and when this happens (paragraph (2)). Alternatively, it may still want the other party to perform, in which case it must seek performance within a reasonable time after it has or ought to have become aware of the non-performance (see Article 7.2.2(e)).

This Article does not deal with the situation where the non-performing party asks the aggrieved party whether it will accept late performance. Nor does it deal with the situation where the aggrieved party learns from another source that the non-performing party intends nevertheless to perform the contract. In such cases good faith and fair dealing (see Article 1.7) may require that the aggrieved party inform the other party if it does not wish to accept the late performance. If it does not do so, it may be held liable in damages.

**3. “Reasonable time”**

An aggrieved party who intends to terminate the contract must give notice to the other party within a reasonable time after it becomes or ought to have become aware of the non-performance (paragraph (2)).

What is “reasonable” depends upon the circumstances. In situations where the aggrieved party may easily obtain a substitute performance and may thus speculate on a rise or fall in the price, notice must be given without delay. When it must make enquiries as to whether it can obtain substitute performance from other sources the reasonable period of time will be longer.

**4. Notice must be received**

The notice to be given by the aggrieved party becomes effective when the non-performing party receives it (see Article 1.10).

**ARTICLE 7.3.3**

*(Anticipatory non-performance)*

**Where prior to the date for performance by one of the parties it is clear that there will be a fundamental non-performance by that party, the other party may terminate the contract.**

**COMMENT**

This Article establishes the principle that a non-performance which is to be expected is to be equated with a non-performance which occurred at the time when performance fell due. It is a requirement that it be clear that there will be non-performance; a suspicion, even a well-founded one, is not sufficient. Furthermore, it is necessary that the non-performance be fundamental and that the party who is to receive performance give notice of termination.

An example of anticipatory non-performance is the case where one party declares that it will not perform the contract; however, the circumstances also may indicate that there will be a fundamental non-performance.

### Illustration

A promises to deliver oil to B by M/S Paul at the terminal in country X on 3 February. On 25 January M/S Paul is still 2,000 kilometres from the terminal. At the speed it is making it will not arrive on 3 February, but at the earliest on 8 February. As time is of the essence, a substantial delay is to be expected, and B may terminate the contract before 3 February.

### ARTICLE 7.3.4

*(Adequate assurance of due performance)*

**A party who reasonably believes that there will be a fundamental non-performance by the other party may demand adequate assurance of due performance and may meanwhile withhold its own performance. Where this assurance is not provided within a reasonable time the party demanding it may terminate the contract.**

### COMMENT

#### **1. Reasonable expectation of fundamental non-performance**

This Article protects the interest of a party who has reason to believe that the other will be unable or unwilling to perform the contract at the due date but who cannot invoke Article 7.3.3 since there is still a possibility that the other party will or can perform. In the absence of the rule laid down in this Article the former party would often be in a dilemma. If it were to wait until the due date of performance, and this did not take place, it might incur loss. If, on the other hand, it were to terminate the contract, and it then became apparent that the contract would have been performed by the other party, its action will amount to non-performance of the contract, and it will be liable in damages.

#### **2. Right to withhold performance pending adequate assurance of performance**

Consequently this Article enables a party who reasonably believes that there will be a fundamental non-performance by the other party to demand an assurance of performance from the other party and in the

meantime to withhold its own performance. What constitutes an adequate assurance will depend upon the circumstances. In some cases the other party's declaration that it will perform will suffice, while in others a request for security or for a guarantee from a third person may be justified.

#### **Illustration**

A, a boatbuilder with only one berth, promises to build a yacht for B to be delivered on 1 May, and no later. Soon afterwards, B learns from C that A has promised to build a yacht for C during the same period. B is entitled to ask A for an adequate assurance that the yacht will be delivered on time and A will then have to give B a satisfactory explanation of how it intends to perform its contract with B.

### **3. Termination of the contract**

If adequate assurance of due performance is not given the other party may terminate the contract.

#### **ARTICLE 7.3.5**

*(Effects of termination in general)*

**(1) Termination of the contract releases both parties from their obligation to effect and to receive future performance.**

**(2) Termination does not preclude a claim for damages for non-performance.**

**(3) Termination does not affect any provision in the contract for the settlement of disputes or any other term of the contract which is to operate even after termination.**

#### **COMMENT**

##### **1. Termination extinguishes future obligations**

Paragraph (1) of this Article states the general rule that termination has effects for the future in that it releases both parties from their duty to effect and to receive future performance.

## 2. Claim for damages not affected

The fact that, by virtue of termination, the contract is brought to an end, does not deprive the aggrieved party of its right to claim damages for non-performance in accordance with the rules laid down in Section 4 of this Chapter.

### Illustration

1. A sells B specified production machinery. After B has begun to operate the machinery serious defects in it lead to a shutdown of B's assembly plant. B declares the contract terminated but may still claim damages (see Article 7.3.5(2)).

## 3. Contract provisions not affected by termination

Notwithstanding the general rule laid down in paragraph (1), there may be provisions in the contract which survive its termination. This is the case in particular with provisions relating to dispute settlement but there may be others which by their very nature are intended to operate even after termination.

### Illustration

2. The facts are the same as in Illustration 1, except that A discloses to B confidential information which is necessary for the production and which B agrees not to divulge for as long as it does not become public knowledge. The contract further contains a clause referring disputes to the courts of A's country. Even after termination of the contract by B, B remains under a duty not to divulge the confidential information, and any dispute relating to the contract and its effects are to be settled by the courts of A's country (see Article 7.3.5(3)).

## ARTICLE 7.3.6

*(Restitution with respect to contracts  
to be performed at one time)*

**(1) On termination of a contract to be performed at one time either party may claim restitution of whatever it has supplied under the contract, provided that such party concurrently makes restitution of whatever it has received under the contract.**

**(2) If restitution in kind is not possible or appropriate, an allowance has to be made in money whenever reasonable.**

**(3) The recipient of the performance does not have to make an allowance in money if the impossibility to make restitution in kind is attributable to the other party.**

**(4) Compensation may be claimed for expenses reasonably required to preserve or maintain the performance received.**

## **COMMENT**

### **1. Contracts to be performed at one time**

This Article refers only to contracts to be performed at one time. A different regime applies to contracts under which the characteristic performance is to be made over a period of time (see Article 7.3.7). The most common example of a contract to be performed at one time is an ordinary contract of sale where the entire object of the sale has to be transferred at one particular moment. This Article however refers also to, e.g. construction contracts in which the contractor is under an obligation to produce the entire work to be accepted by the customer at one particular time. A turnkey contract provides an important example.

Under a commercial contract one party will usually have to pay money for the performance received. That obligation is not the one that is characteristic of the contract. Thus, a contract of sale where the purchase price has to be paid in instalments, will fall under this Article provided that the seller's performance is to be made at one time.

### **2. Right of parties to restitution on termination**

Paragraph (1) of this Article gives each party a right to claim the return of whatever the party has supplied under the contract provided that that party concurrently makes restitution of whatever it has received.

## **Illustration**

1. In the process of a takeover of a company, controlling shareholder A agrees to sell and transfer to B shares for GBP 1,000,000. B only pays GBP 600,000 after the shares have been transferred and A therefore terminates the contract. A can claim back the shares. At the same time, A has to return the GBP 600,000 received from B.

This rule also applies when the aggrieved party has made a bad bargain. If, in the case mentioned in Illustration 1, the real market value of the shares is GBP 1,200,000, A may still require the return of the shares.

This Article also applies to the situation where the aggrieved party has supplied money in exchange for property, services, or other performances which the party has not received or which are defective.

#### Illustration

2. Art dealer A sells a Constable painting to art dealer B for EUR 600,000. B only pays EUR 200,000 for the painting, and A therefore terminates the contract. Subsequently it turns out that the painting is not a Constable but a copy. On termination of the contract, B can reclaim the purchase price and must return the painting to A.

As regards the costs involved in making restitution, Article 6.1.11 applies.

### 3. Restitution in kind not possible or appropriate

Restitution must normally be made in kind. There are, however, instances where instead of restitution in kind, an allowance in money has to be made. This is the case first of all where restitution in kind is not possible. The allowance will normally amount to the value of the performance received.

#### Illustrations

3. Company A, which has contracted to excavate company B's site, leaves it after only part of the work has been done. B, which then terminates the contract, will have to pay A a sum in compensation for the work done, measured by the value that work has for B. At the same time B will have a claim against A for whatever damages B may have suffered as a result of A's breach of contract (see Article 7.3.5 (2)).
4. Company A chartered a ship for a company cruise for its employees which is to take them up the Australian Coral Reef. Half-way the cruise ship breaks down and cannot continue the cruise. A terminates the contract with B, the owner of the business organising the cruise, and decides to fly its employees home. If A had already paid the price A can now claim it back. At the same time, A owes B an allowance amounting to the value of the cruise so far. In addition, A can claim damages for the loss suffered as a result of B's non-performance (see Article 7.3.5 (2)).

An allowance is further envisaged by paragraph (2) of this Article whenever restitution in kind would not be appropriate. This is so in

particular when returning the performance in kind would cause unreasonable effort or expense. The standard, in that respect, is the same as under Article 7.2.2(b).

#### **Illustration**

5. A, an artist, sells 200 silver-plated rings to dealer B. B fails to pay for the rings and A thereupon terminates the contract. It turns out that B has, in the meantime, attempted to ship the rings to his business premises. However, the boat on which they had been stored has sunk. Although it would be possible, at great expense, to rescue the rings from the wrecked ship, this cannot be expected of B. B has to pay a reasonable sum to A, measured by the value of the rings.

The purpose of specifying that an allowance has to be made in money “whenever reasonable” is to make it clear that an allowance only has to be made if, and to the extent that, the performance has conferred a benefit on its recipient. That is not the case, for example, where the defect which gives the recipient of the performance a right to terminate has only become apparent in the course of processing the object of that performance.

#### **Illustration**

6. Company A hires company B to develop a specialised software to improve its existing internal communication system. Once B has developed and installed the software, the software does not perform the functions it was intended to. A can terminate the contract and reclaim the price paid, but since the installed system has no value for A, it would not be reasonable to expect A to pay B an allowance for the installed software.

### **4. The allocation of risk**

The rule contained in paragraph (2) implies an allocation of risk: it imposes a liability on the recipient of the performance to make good the value of that performance if it is unable to make restitution in kind. The rule in paragraph (2) applies even if the recipient was responsible for the deterioration or destruction of what it had received. Such allocation of the risk of deterioration or destruction is justified, in particular, because the risk should lie with the person in control of the performance. On the contrary, there is no liability to make good the value where the deterioration or destruction is attributable to the other party: either because it was due to the other party’s fault, or because it was due to a defect inherent in the performance. Hence the rule in paragraph (3).



### Illustration

7. Manufacturer A sells and delivers a luxury car to company B. The car has defective brakes. Due to this defect it crashes into another car and is totally destroyed. Since the car was unfit to be used for its intended purpose, B can terminate the contract and reclaim the purchase price. B does not have to make an allowance for not being able to return the car.

The recipient's liability to make good the value of the performance received is not excluded in cases where the deterioration or destruction would also have occurred had the performance not been rendered.

### Illustration

8. Manufacturer A sells and delivers a car to company B. After delivery has taken place, the car is totally destroyed by a hurricane flooding the properties of both A and B. B terminates the contract because of a defect attaching to the car. B can reclaim the purchase price but, at the same time, has to make an allowance for the value of the car prior to its destruction.

The question of the recipient's liability to pay the value of the performance only arises in cases where the deterioration or destruction occurs before termination of the contract. If what has been performed deteriorates or is destroyed after termination of the contract, the normal rules on non-performance apply, as after termination the recipient of the performance is under a duty to return what the recipient has received. Any non-performance of that duty gives the other party a right to claim damages according to Article 7.4.1, unless the non-performance is excused under Article 7.1.7.

### Illustration

9. Company A sells and delivers to company B a limousine with a leaking roof. Since the limousine is unfit to be used for its intended purpose, B can terminate the contract. As a result, B can reclaim the purchase price but is under a duty to return the limousine. Before B can return the car it is totally destroyed by a thunderstorm. A cannot claim damages because B is excused under Article 7.1.7.

## 5. Compensation for expenses

The recipient of a performance may have incurred expenses for the preservation or maintenance of the object of the performance. It is reasonable to allow the recipient to claim compensation for these expenses where the contract has been terminated and where, therefore, the parties have to return what they have received.

**Illustration**

10. Company A has sold and delivered a race horse to company B. Some time later it becomes apparent that the horse is not, as A had promised, a descendant of a particular stallion. B terminates the contract. B can claim compensation for the costs incurred in feeding and caring for the horse.

This rule applies only to reasonable expenses. What is reasonable depends on the circumstances of the case. In Illustration 10 it would matter whether the horse had been sold as a race horse or as an ordinary farm horse.

Compensation cannot be claimed for other expenses linked to the performance received, even if they are reasonable.

**Illustration**

11. Company A has sold and delivered a software package to company B. B then discovers that the software is lacking a certain functionality it was supposed to have. B therefore asks software expert C to check whether that functionality can still be implemented. Since that turns out not to be possible, B terminates the contract. B cannot recover the fee paid to C as expenses under paragraph (4) from A.

**6. Benefits**

The Principles do not take a position concerning benefits that have been derived from the performance, or interest that has been earned. In commercial practice it will often be difficult to establish the value of the benefits received by the parties as a result of the performance. Furthermore, often both parties will have received such benefits.

**7. Rights of third persons not affected**

In common with other Articles of the Principles, this Article deals with the relationship between the parties and not with any rights on the goods concerned that third persons may have acquired. Whether, for instance, an obligee of the buyer, the buyer's receivers in bankruptcy, or a purchaser in good faith may oppose the restitution of goods sold is to be determined by the applicable law.

**ARTICLE 7.3.7**

*(Restitution with respect to contracts  
to be performed over a period of time)*

**(1) On termination of a contract to be performed over a period of time restitution can only be claimed for the period after termination has taken effect, provided the contract is divisible.**

**(2) As far as restitution has to be made, the provisions of Article 7.3.6 apply.**

**COMMENT****1. Contracts to be performed over a period of time**

Contracts to be performed over a period of time are at least as commercially important as contracts to be performed at one time, such as contracts of sale where the object of the sale has to be transferred at one particular moment. These contracts include leases (e.g. equipment leases), contracts involving distributorship, out-sourcing, franchising, licensing and commercial agency, as well as service contracts in general. This Article also covers contracts of sale where the goods have to be delivered in instalments. Performances under such contracts can have been made over a long period of time before the contract is terminated, and it may thus be inconvenient to unravel these performances. Furthermore, termination is a remedy with prospective effect only. Restitution can, therefore, only be claimed in respect of the period after termination.

**Illustration**

1. A contracts to service company B's computer hardware and software for a period of five years. After three years of regular service A is obliged by illness to discontinue the services and the contract is terminated. B, who has paid A for the fourth year, can claim restitution of the advance payment for that year but not for the money paid for the three years of regular service.

Since contracts are terminated only for the future, any outstanding payments for past performances can still be claimed. This Article does not prevent a claim for damages being brought.

**Illustrations**

2. Company A leases equipment to company B for three years at a rental of EUR 10,000 a month. B pays punctually for the first two months but then fails to make any further payments despite repeated requests by A. After a lapse of five months A terminates the lease. A is entitled to retain the EUR 20,000 already received (see Article 7.3.7 (1)) and to recover the EUR 50,000 accrued due (on the basis of the contract of lease which is terminated only for the future), together with whatever damages for breach it has sustained (see Article 7.3.5 (2)).

3. A, a hospital, engages B to carry out cleaning services for the hospital, the contract to run for three years. After a year B informs A that it cannot continue with the cleaning services unless the price is doubled. A refuses to agree and B ceases to provide the service. On terminating the contract A can recover damages for any additional expense it incurs in hiring another cleaning firm (see Article 7.4.1 in conjunction with Article 7.3.5 (2)), while B is entitled to retain the payments it has received for services already provided (see Article 7.3.7 (1)).

The rule that restitution can only be claimed for the period after termination has taken effect does not apply if the contract is indivisible.

**Illustration**

4. A undertakes to paint ten pictures depicting one and the same historical event for B's festival hall. After delivering and having been paid for five paintings, A abandons the work. In view of the fact that the decoration of the hall is supposed to consist of ten paintings to be painted by the same painter and showing different aspects of one historical event, B can claim the return of the advances paid to A and must return the five paintings to A.

**2. Restitution**

This Article is a special rule which, for contracts to be performed over a period of time, excludes restitution for performances made in the past. To the extent that there is restitution under this Article, it is governed by the provisions under Article 7.3.6.

## SECTION 4: DAMAGES

### ARTICLE 7.4.1

*(Right to damages)*

**Any non-performance gives the aggrieved party a right to damages either exclusively or in conjunction with any other remedies except where the non-performance is excused under these Principles.**

#### COMMENT

##### **1. Right to damages in general**

This Article establishes the principle of a general right to damages in the event of non-performance, except where the non-performance is excused under the Principles, as in the case of force majeure (see Article 7.1.7) or of an exemption clause (see Article 7.1.6). Hardship (see Article 6.2.1 *et seq.*) does not in principle give rise to a right to damages.

The Article recalls that the right to damages, like other remedies, arises from the sole fact of non-performance. It is enough for the aggrieved party simply to prove the non-performance, i.e. that it has not received what it was promised. In particular, it is not necessary in addition to prove that the non-performance was due to the fault of the non-performing party. The degree of difficulty in proving the non-performance will depend upon the content of the obligation and in particular on whether the obligation is one of best efforts or one to achieve a specific result (see Article 5.1.4).

The right to damages exists in the event of failure to perform any of the obligations which arise from the contract. Thus, it is not necessary to draw a distinction between principal and accessory obligations.

##### **2. Damages may be combined with other remedies**

This Article also states that the aggrieved party may request damages either as an exclusive remedy (for example, damages for delay in the case of late performance or for defective performance accepted by the aggrieved party; damages in the event of impossibility of performance for which the non-performing party is liable), or in conjunction

with other remedies. Thus, in the case of termination of the contract, damages may be requested to compensate the loss arising from such termination, or again, in the case of specific performance, to compensate for the delay with which the aggrieved party receives performance and for any expenses which might have been incurred. Damages may also be accompanied by other remedies (cure, publication in newspapers of, for example, an admission of error, etc.).

### **3. Damages and pre-contractual liability**

The right to damages may arise not only in the context of non-performance of the contract, but also during the pre-contractual period (see, for instance, Article 2.1.15 in case of negotiations in bad faith, Article 2.1.16 in the event of breach of the duty of confidentiality, or Article 3.2.16 in the case of mistake, fraud, threat or gross disparity). The rules governing damages for non-performance as laid down in this Section may be applied by analogy to those situations.

#### **ARTICLE 7.4.2**

*(Full compensation)*

**(1) The aggrieved party is entitled to full compensation for harm sustained as a result of the non-performance. Such harm includes both any loss which it suffered and any gain of which it was deprived, taking into account any gain to the aggrieved party resulting from its avoidance of cost or harm.**

**(2) Such harm may be non-pecuniary and includes, for instance, physical suffering or emotional distress.**

#### **COMMENT**

##### **1. Aggrieved party entitled to full compensation**

Paragraph (1) of this Article establishes the principle of the aggrieved party's entitlement to full compensation for the harm it has sustained as a result of the non-performance of the contract. It further affirms the need for a causal link between the non-performance and the harm (see also Comment 3 on Article 7.4.3). Non-performance must be a source neither of gain nor of loss for the aggrieved party.

The solution to be found in some legal systems which allows the court to reduce the amount of damages having regard to the circumstances has not been followed, since in international situations it could risk creating a considerable degree of uncertainty and its application might moreover vary from one court to another.

## **2. Damages cover loss suffered, including loss of profit**

In specifying the harm for which damages are recoverable, paragraph (1) of this Article, following the rule laid down in Article 74 CISG, states that the aggrieved party is entitled to compensation in respect not only of loss which it has suffered, but also of any gain of which it has been deprived as a consequence of the non-performance.

The notion of loss suffered must be understood in a wide sense. It may cover a reduction in the aggrieved party's assets or an increase in its liabilities which occurs when an obligee, not having been paid by its obligor, must borrow money to meet its commitments. The loss of profit or, as it is sometimes called, consequential loss, is the benefit which would normally have accrued to the aggrieved party if the contract had been properly performed. The benefit will often be uncertain so that it will frequently take the form of the loss of a chance (see Article 7.4.3(2)).

### **Illustrations**

1. A national library sends a rare manuscript by special courier abroad for an exhibition. The manuscript is irreparably damaged during transport. Its loss in value is estimated at EUR 100,000 and it is this sum which is due by the courier.
2. A, who has not been paid by B under the terms of their contract, must borrow money from its bank at a high rate of interest. B must compensate A for the interest due by the latter to its bank.
3. A, a construction company, hires a crane from company B. The boom of the crane, which has been poorly maintained, breaks and in falling crushes the architect's car and results in an interruption of work on the site for eight days, for which A must pay a penalty for delay of EUR 50,000 to the owner. B must reimburse A for the expenses incurred as a consequence of the interruption of the work, the amount of the penalty and the cost of repairing the architect's car which A has had to pay.
4. A, a singer, cancels an engagement with B, an impresario. A must pay damages to B in respect not only of the expenses incurred by B in preparing the concert, but also of the loss of profit resulting from the cancellation of the concert.

**3. Damages must not enrich the aggrieved party**

However, the aggrieved party must not be enriched by damages for non-performance. It is for this reason that paragraph (1) also provides that account must be taken of any gain resulting to the aggrieved party from the non-performance, whether that be in the form of expenses which it has not incurred (e.g. it does not have to pay the cost of a hotel room for an artist who fails to appear), or of a loss which it has avoided (e.g. in the event of non-performance of what would have been a losing bargain for it).

**Illustration**

5. A rents out excavating machinery to B for two years at a monthly rental of EUR 10,000. The contract is terminated after six months for non-payment of the rentals. Six months later, A succeeds in renting out the same machinery at a monthly charge of EUR 11,000. The gain of EUR 12,000 realised by A as a result of the re-letting of the machinery for the remainder of the initial contract, that is to say one year, should be deducted from the damages due by B to A.

**4. Damages in case of changes in the harm**

In application of the principle of full compensation regard is to be had to any changes in the harm, including its expression in monetary terms, which may occur between the time of the non-performance and that of the judgment. The rule however is not without exceptions: for example, if the aggrieved party has itself already made good the harm at its own expense, the damages awarded will correspond to the amount of the sums disbursed.

**5. Compensation of non-material harm**

Paragraph (2) of this Article expressly provides for compensation also of non-pecuniary harm. This may be pain and suffering, loss of certain amenities of life, aesthetic prejudice, etc. as well as harm resulting from attacks on honour or reputation.

The rule might find application, in international commerce, in regard to contracts concluded by artists, outstanding sportsmen or women and consultants engaged by a company or by an organisation.



In these cases also, the requirement of the certainty of harm must be satisfied (see Article 7.4.3), together with the other conditions for entitlement to damages.

#### Illustration

6. A, a young architect who is beginning to build up a certain reputation, signs a contract for the modernisation of a municipal fine arts museum. The appointment receives wide press coverage. The municipal authorities subsequently decide to engage the services of a more experienced architect and terminate the contract with A. A may obtain compensation not only for the material loss suffered but also for the harm to A's reputation and the loss of the chance of becoming better known which the commission would have provided.

The compensation of non-material harm may assume different forms and it is for the court to decide which of them, whether taken alone or together, best assures full compensation. The court may not only award damages but also order other forms of redress such as the publication of a notice in newspapers designated by it (e.g. in case of breach of a clause prohibiting competition or the reopening of a business, defamation etc.).

#### ARTICLE 7.4.3

*(Certainty of harm)*

**(1) Compensation is due only for harm, including future harm, that is established with a reasonable degree of certainty.**

**(2) Compensation may be due for the loss of a chance in proportion to the probability of its occurrence.**

**(3) Where the amount of damages cannot be established with a sufficient degree of certainty, the assessment is at the discretion of the court.**

**COMMENT****1. Occurrence of harm must be reasonably certain**

This Article reaffirms the well-known requirement of certainty of harm, since it is not possible to require the non-performing party to compensate harm which may not have occurred or which may never occur.

Paragraph (1) permits the compensation also of future harm, i.e. harm which has not yet occurred, provided that it is sufficiently certain. Paragraph (2) in addition covers loss of a chance, obviously only in proportion to the probability of its occurrence: thus, the owner of a horse which arrives too late to run in a race as a result of delay in transport cannot recover the whole of the prize money, even though the horse was the favourite.

**2. Determination of extent of harm**

Certainty relates not only to the existence of the harm but also to its extent. There may be harm the existence of which cannot be disputed but which it is difficult to quantify. This will often be the case in respect of loss of a chance (there are not always “odds” as there are for a horse, for example for an engineering company preparing for the making of a bid) or of compensation for non-material harm (detriment to someone’s reputation, pain and suffering, etc.).

**Illustration**

A entrusts a file to B, an express delivery company, in response to an invitation to submit tenders for the construction of an airport. B undertakes to deliver the file before the closing date for tenders but delivers it after that date and A’s application is refused. The amount of compensation will depend upon the degree of probability of A’s tender having been accepted and calls for a comparison of it with the applications which were admitted for consideration. The compensation will therefore be calculated as a proportion of the profit which A might have made.

According to paragraph (3), where the amount of damages cannot be established with a sufficient degree of certainty then, rather than refuse any compensation or award nominal damages, the court is empowered to make an equitable quantification of the harm sustained.

**3. Harm must be a direct consequence of non-performance as well as certain**

There is a clear connection between the certainty and the direct nature of the harm. Although the latter requirement is not expressly dealt with by the Principles, it is implicit in Article 7.4.2(1) which refers to the harm sustained “as a result of the non-performance” and which therefore presupposes a sufficient causal link between the non-performance and the harm. Harm which is too indirect will usually also be uncertain as well as unforeseeable.

**ARTICLE 7.4.4**

*(Foreseeability of harm)*

**The non-performing party is liable only for harm which it foresaw or could reasonably have foreseen at the time of the conclusion of the contract as being likely to result from its non-performance.**

**COMMENT**

The principle of limitation of recoverable harm to that which is foreseeable corresponds to the solution adopted in Article 74 CISG. This limitation is related to the very nature of the contract: not all the benefits of which the aggrieved party is deprived fall within the scope of the contract and the non-performing party must not be saddled with compensation for harm which it could never have foreseen at the time of the conclusion of the contract and against the risk of which it could not have taken out insurance.

The requirement of foreseeability must be seen in conjunction with that of certainty of harm set out in Article 7.4.3.

The concept of foreseeability must be clarified since the solution contained in the Principles does not correspond to certain national systems which allow compensation even for harm which is unforeseeable when the non-performance is due to wilful misconduct or gross negligence. Since the present rule does not provide for such an exception, a narrow interpretation of the concept of foreseeability is called for. Foreseeability relates to the nature or type of the harm but not to its extent unless the extent is such as to transform the harm into one of a different kind. In any event, foreseeability is a flexible concept which leaves a wide measure of discretion to the judge.

What was foreseeable is to be determined by reference to the time of the conclusion of the contract and to the non-performing party itself (including its servants or agents), and the test is what a normally diligent person could reasonably have foreseen as the consequences of non-performance in the ordinary course of things and the particular circumstances of the contract, such as the information supplied by the parties or their previous transactions.

### **Illustrations**

1. A cleaning company orders a machine which is delivered five months late. The manufacturer is obliged to compensate the company for lost profit caused by the delay in delivery as it could have foreseen that the machine was intended for immediate use. On the other hand the harm does not include the loss of a valuable Government contract that could have been concluded if the machine had been delivered on time since that kind of harm was not foreseeable.
2. A, a bank, usually employs the services of a security company for the conveyance of bags containing coins to its branches. Without informing the security company, A sends a consignment of bags containing new coins for collectors worth fifty times the value of previous consignments. The bags are stolen in a hold-up. A can only recover compensation corresponding to the value of the normal consignments as this was the only kind of harm that could have been foreseen and the value of the items lost was such as to transform the harm into one of another kind.

Unlike certain international conventions, particularly in the field of transport, the Principles follow CISG in not making provision for full compensation of harm, albeit unforeseeable, in the event of intentional non-performance.

### **ARTICLE 7.4.5**

*(Proof of harm in case of  
replacement transaction)*

**Where the aggrieved party has terminated the contract and has made a replacement transaction within a reasonable time and in a reasonable manner it may recover the difference between the contract price and the price of the replacement transaction as well as damages for any further harm.**

**COMMENT****1. Amount of harm presumed in case of replacement transaction**

It seems advisable to establish, alongside the general rules applicable to the proof of the existence and of the amount of the harm, presumptions which may facilitate the task of the aggrieved party.

The first of these presumptions is provided by this Article which corresponds in substance to Article 75 CISG. It concerns the situation where the aggrieved party has made a replacement transaction, for instance because so required by the duty to mitigate harm or in conformity with usages. In such cases, the harm is considered to be the difference between the contract price and the price of the replacement transaction.

The presumption comes into play only if there is a replacement transaction and not where the aggrieved party has itself performed the obligation which lay upon the non-performing party (for example when a shipowner itself carries out the repairs to its vessel following the failure to do so of the shipyard which had been entrusted with the work).

Nor is there replacement, and the general rules will apply, when a company, after the termination of a contract, uses its equipment for the performance of another contract which it could have performed at the same time as the first ("lost volume").

The replacement transaction must be performed within a reasonable time and in a reasonable manner so as to avoid the non-performing party being prejudiced by hasty or malicious conduct.

**2. Further damages recoverable for additional harm**

The rule that the aggrieved party may recover the difference between the two contract prices establishes a minimum right of recovery. The aggrieved party may also obtain damages for additional harm which it may have sustained.

**Illustration**

A, a shipyard, undertakes to accommodate a ship belonging to B, a shipowner, in dry dock for repairs costing USD 500,000 as from 1 July. B learns on 1 June that the dry dock will only be available as from 1 August. B terminates the contract and after lengthy and costly negotiations concludes with C, another shipyard, an identical contract at a price of USD 700,000. B is entitled to recover from A not only the difference in the price of USD 200,000 but also the expenses it has incurred and compensation for the longer period of unavailability of the ship.

**ARTICLE 7.4.6**

*(Proof of harm by current price)*

**(1) Where the aggrieved party has terminated the contract and has not made a replacement transaction but there is a current price for the performance contracted for, it may recover the difference between the contract price and the price current at the time the contract is terminated as well as damages for any further harm.**

**(2) Current price is the price generally charged for goods delivered or services rendered in comparable circumstances at the place where the contract should have been performed or, if there is no current price at that place, the current price at such other place that appears reasonable to take as a reference.**

**COMMENT****1. Amount of harm presumed when no replacement transaction**

The purpose of this Article, which corresponds in substance to Article 76 CISG, is to facilitate proof of harm where no replacement transaction has been made, but there exists a current price for the performance contracted for. In such cases the harm is presumed to be equal to the difference between the contract price and the price current at the time the contract was terminated.

**2. Determination of “current price”**

According to paragraph (2) “current price” is the price generally charged for the goods or services in question. The price will be determined in comparison with that which is charged for the same or similar goods or services. This will often, but not necessarily, be the price on an organised market. Evidence of the current price may be obtained from professional organisations, chambers of commerce etc.

For the purpose of this Article the place relevant for determining the current price is that where the contract should have been performed or, if there is no current price at that place, the place that appears reasonable to take as a reference.

### 3. Further damages recoverable for additional harm

The rule that the aggrieved party may recover the difference between the contract price and the current price at the time of termination establishes only a minimum right of recovery. The aggrieved party may also obtain damages for additional harm which it may have sustained as a consequence of termination.

#### ARTICLE 7.4.7

*(Harm due in part to aggrieved party)*

**Where the harm is due in part to an act or omission of the aggrieved party or to another event for which that party bears the risk, the amount of damages shall be reduced to the extent that these factors have contributed to the harm, having regard to the conduct of each of the parties.**

#### COMMENT

##### 1. Contribution of the aggrieved party to the harm

In application of the general principle established by Article 7.1.2 which restricts the exercise of remedies where non-performance is in part due to the conduct of the aggrieved party, this Article limits the right to damages to the extent that the aggrieved party has in part contributed to the harm. It would indeed be unjust for such a party to obtain full compensation for harm for which it has itself been partly responsible.

##### 2. Ways of contributing to the harm

The contribution of the aggrieved party to the harm may consist either in its own conduct or in an event for which it bears the risk. The conduct may take the form of an act (e.g. it gave a carrier a mistaken address) or an omission (e.g. it failed to give all the necessary instructions to the constructor of the defective machinery). Most frequently such acts or omissions will result in the aggrieved party failing to perform one or another of its own contractual obligations; they may however equally consist in tortious conduct or non-performance of

another contract. The external events for which the aggrieved party bears the risk may, among others, be acts or omissions of persons for whom it is responsible such as its servants or agents.

#### Illustrations

1. A, a franchisee bound by an “exclusivity” clause contained in the contract with B, acquires stock from C because B has required immediate payment despite the fact that the franchise agreement provides for payment at 90 days. B claims payment of the penalty stipulated for breach of the exclusivity clause. B will obtain only part of the sum due thereunder as it was B who provoked A’s non-performance.
2. A, a passenger on a liner effecting a luxury cruise, is injured when a lift fails to stop at the floor requested. B, the shipowner, is held liable for the consequences of A’s injury and seeks recourse against C, the company which had checked the lifts before the liner’s departure. It is proved that the accident would have been avoided if the floor had been better lit. Since this was B’s responsibility, B will not obtain full recovery from C.

### **3. Apportionment of contribution to the harm**

The conduct of the aggrieved party or the external events as to which it bears the risk may have made it absolutely impossible for the non-performing party to perform. If the requirements of Article 7.1.7 (*Force majeure*) are satisfied, the non-performing party is totally exonerated from liability.

Otherwise, the exoneration will be partial, depending on the extent to which the aggrieved party contributed to the harm. The determination of each party’s contribution to the harm may well prove to be difficult and will to a large degree depend upon the exercise of judicial discretion. In order to give some guidance to the court this Article provides that the court shall have regard to the respective behaviour of the parties. The more serious a party’s failing, the greater will be its contribution to the harm.

#### Illustrations

3. The facts are the same as in Illustration 1. Since it was B who was the first not to observe the terms of the contract, B is deemed to have caused A’s failure to respect the exclusivity clause. B may only recover 25% of the amount stipulated in the penalty clause.



4. The facts are the same as in Illustration 2. Since the failings of B and C seem to be equivalent, B can only recover from C 50% of the compensation it had to pay A.

#### **4. Contribution to harm and mitigation of harm**

This Article must be read in conjunction with the following Article on mitigation of harm (see Article 7.4.8). While this Article is concerned with the conduct of the aggrieved party in regard to the cause of the initial harm, Article 7.4.8 relates to that party's conduct subsequent thereto.

#### **ARTICLE 7.4.8**

*(Mitigation of harm)*

**(1) The non-performing party is not liable for harm suffered by the aggrieved party to the extent that the harm could have been reduced by the latter party's taking reasonable steps.**

**(2) The aggrieved party is entitled to recover any expenses reasonably incurred in attempting to reduce the harm.**

#### **COMMENT**

##### **1. Duty of aggrieved party to mitigate harm**

The purpose of this Article is to avoid the aggrieved party passively sitting back and waiting to be compensated for harm which it could have avoided or reduced. Any harm which the aggrieved party could have avoided by taking reasonable steps will not be compensated.

Evidently, a party who has already suffered the consequences of non-performance of the contract cannot be required in addition to take time-consuming and costly measures. On the other hand, it would be unreasonable from the economic standpoint to permit an increase in harm which could have been reduced by the taking of reasonable steps.

The steps to be taken by the aggrieved party may be directed either to limiting the extent of the harm, above all when there is a risk of it lasting for a long time if such steps are not taken (often they will consist in a replacement transaction: see Article 7.4.5), or to avoiding any increase in the initial harm.

**Illustrations**

1. On 2 May, A requests B, a travel agency, to reserve a hotel room in city X for 1 June, at a cost of EUR 200. On 15 May, A learns that B has not made the reservation. A waits however until 25 May before making a new reservation and can only find a room costing EUR 300, whereas accommodation could have been secured for EUR 250 if A had taken action already on 15 May. A can recover only EUR 50 from B.
2. A, a company which has been entrusted by B with the building of a factory, suddenly stops work when the project is nearing completion. B looks for another company to finish the building of the factory but takes no steps to protect the buildings on the site the condition of which deteriorates as a result of bad weather. B cannot recover compensation for such deterioration as it is attributable to its failure to take interim protective measures.

**2. Reimbursement of expenses**

The reduction in damages to the extent that the aggrieved party has failed to take the necessary steps to mitigate the harm must not however cause loss to that party. The aggrieved party may therefore recover from the non-performing party the expenses incurred by it in mitigating the harm, provided that those expenses were reasonable in the circumstances (paragraph (2)).

**Illustrations**

3. The facts are the same as in Illustration 2, except that B has the necessary work carried out to ensure the interim protection of the buildings. The cost of such work will be added to the damages due by A for non-performance of the contract on condition that those costs were reasonable. If they were not, they will be reduced.
4. The facts are the same as in Illustration 1, except that A takes a room costing EUR 500 in a luxury hotel. A may only recover the 50 euro difference in respect of the room which A could have obtained for EUR 250.

**ARTICLE 7.4.9***(Interest for failure to pay money)*

**(1) If a party does not pay a sum of money when it falls due the aggrieved party is entitled to interest upon that sum from the time when payment is due to the time of payment whether or not the non-payment is excused.**

**(2) The rate of interest shall be the average bank short-term lending rate to prime borrowers prevailing for the currency of payment at the place for payment, or where no such rate exists at that place, then the same rate in the State of the currency of payment. In the absence of such a rate at either place the rate of interest shall be the appropriate rate fixed by the law of the State of the currency of payment.**

**(3) The aggrieved party is entitled to additional damages if the non-payment caused it a greater harm.**

**COMMENT****1. Lump sum compensation for failure to pay a sum of money**

This Article reaffirms the widely accepted rule according to which the harm resulting from delay in the payment of a sum of money is subject to a special regime and is calculated by a lump sum corresponding to the interest accruing between the time when payment of the money was due and the time of actual payment.

Interest is payable whenever the delay in payment is attributable to the non-performing party, and this as from the time when payment was due, without any need for the aggrieved party to give notice of the default.

If the delay is the consequence of force majeure (e.g. the non-performing party is prevented from obtaining the sum due by reason of the introduction of new exchange control regulations), interest will still be due not as damages but as compensation for the enrichment of the debtor as a result of the non-payment as the debtor continues to receive interest on the sum which it is prevented from paying.

The harm is calculated as a lump sum. In other words, subject to paragraph (3) of this Article, the aggrieved party may not prove that it

could have invested the sum due at a higher rate of interest or the non-performing party that the aggrieved party would have obtained interest at a rate lower than the average lending rate referred to in paragraph (2).

The parties may of course agree in advance on a different rate of interest (which would in effect subject it to Article 7.4.13).

## **2. Rate of interest**

Paragraph (2) of this Article fixes in the first instance as the rate of interest the average bank short-term lending rate to prime borrowers. This solution seems to be that best suited to the needs of international trade and most appropriate to ensure an adequate compensation of the harm sustained. The rate in question is the rate at which the aggrieved party will normally borrow the money which it has not received from the non-performing party. That normal rate is the average bank short-term lending rate to prime borrowers prevailing at the place for payment for the currency of payment.

No such rate may however exist for the currency of payment at the place for payment. In such cases, reference is made in the first instance to the average prime rate in the State of the currency of payment. For instance, if a loan is made in pounds sterling payable in country X and there is no rate for loans in pounds on country X financial market, reference will be made to the rate in the United Kingdom.

In the absence of such a rate at either place, the rate of interest will be the “appropriate” rate fixed by the law of the State of the currency of payment. In most cases this will be the legal rate of interest and, as there may be more than one, that most appropriate for international transactions. If there is no legal rate of interest, the rate will be the most appropriate bank rate.

## **3. Additional damages recoverable**

Interest is intended to compensate the harm normally sustained as a consequence of delay in payment of a sum of money. Such delay may however cause additional harm to the aggrieved party for which it may recover damages, always provided that it can prove the existence of such harm and that it meets the requirements of certainty and foreseeability (paragraph (3)).

### Illustration

A concludes a contract with B, a specialised finance company, for a loan which will permit the renovation of its factory in country X. The loan specifically mentions the use of the funds. The money lent is transferred three months later than agreed. During that period the cost of the renovation has increased by ten percent. A is entitled to recover this additional sum from B.

### ARTICLE 7.4.10

*(Interest on damages)*

**Unless otherwise agreed, interest on damages for non-performance of non-monetary obligations accrues as from the time of non-performance.**

### COMMENT

This Article determines the time from which interest on damages accrues in cases of non-performance of obligations other than monetary obligations. In such cases, at the time of non-performance the amount of damages will usually not yet have been assessed in monetary terms. The assessment will only be made after the occurrence of the harm, either by agreement between the parties or by the court.

This Article fixes as the starting point for the accrual of interest the date of the occurrence of the harm. This solution is that best suited to international trade where it is not the practice for businesspersons to leave their money idle. In effect, the aggrieved party's assets are diminished as from the occurrence of the harm whereas the non-performing party, for as long as the damages are not paid, continues to enjoy the benefit of the interest on the sum which it will have to pay. It is only natural that this gain passes to the aggrieved party.

However, when making the final assessment of the harm, regard is to be had to the fact that damages are awarded as from the date of the harm, so as to avoid double compensation, for instance when a currency depreciates in value.

This Article takes no stand on the question of compound interest, which in some national laws is subject to rules of public policy limiting compound interest with a view to protecting the non-performing party.

**ARTICLE 7.4.11***(Manner of monetary redress)*

**(1) Damages are to be paid in a lump sum. However, they may be payable in instalments where the nature of the harm makes this appropriate.**

**(2) Damages to be paid in instalments may be indexed.**

**COMMENT****1. Lump sum or instalments**

Although this Article does not impose a fixed rule as to the manner in which damages are to be paid, the payment of damages as a lump sum is in general considered to be the mode of payment best suited to international trade. There are however situations in which payment by instalments will be more appropriate, having regard to the nature of the harm, for instance when the harm is on-going.

**Illustrations**

1. A, a consultant, is retained by B for the purpose of checking the safety of its factories. A is killed when travelling by helicopter to one of B's factories, for which accident B is held responsible. A leaves two children aged twelve and eight. So as to compensate for the loss of the maintenance of the family, a monthly allowance will be payable to the children until they reach the age of majority.
2. A, a consultant in safety matters, is recruited by B for a three year period. The remuneration is fixed at 0.5% of the production. A is wrongfully dismissed after six months. It may be appropriate that B be ordered to pay A monthly a sum corresponding to the agreed salary until A has found new employment or, at the most, for thirty months.

**2. Indexation**

Paragraph (2) of this Article contemplates the possibility of indexation of damages to be paid in instalments so as to avoid the complex mechanism of a review of the original judgment in order to take account of inflation. Indexation may however be prohibited by the law of the forum.

## Illustration

3. The facts are the same as in Illustration 1. The monthly allowance may be adjusted in accordance with the cost of living index applicable where the children live.

**ARTICLE 7.4.12**

*(Currency in which to assess damages)*

**Damages are to be assessed either in the currency in which the monetary obligation was expressed or in the currency in which the harm was suffered, whichever is more appropriate.**

**COMMENT**

The harm resulting from the non-performance of an international contract may occur in different places and the question therefore arises of the currency in which it is to be assessed. This question is dealt with by this Article and should be kept distinct from that of the currency of payment of the damages addressed in Article 6.1.9.

The Article offers a choice between the currency in which the monetary obligation was expressed and that in which the harm was suffered, whichever is more appropriate in the circumstances.

While the first alternative calls for no particular comment, the second takes account of the fact that the aggrieved party may have incurred expenses in a particular currency to repair damage which it has sustained. In such a case it should be entitled to claim damages in that currency even if it is not the currency of the contract. Another currency which may be considered the most appropriate is that in which the profit would have been made.

The choice is left to the aggrieved party, provided that the principle of full compensation is respected.

Finally, it may be noted that in the absence of any indication to the contrary, a party is entitled to interest and to liquidated damages and penalties in the same currency as that in which the main obligation is expressed.

**ARTICLE 7.4.13**

*(Agreed payment for non-performance)*

**(1) Where the contract provides that a party who does not perform is to pay a specified sum to the aggrieved party for such non-performance, the aggrieved party is entitled to that sum irrespective of its actual harm.**

**(2) However, notwithstanding any agreement to the contrary the specified sum may be reduced to a reasonable amount where it is grossly excessive in relation to the harm resulting from the non-performance and to the other circumstances.**

**COMMENT****1. Agreed payment for non-performance defined**

This Article gives an intentionally broad definition of agreements to pay a specified sum in case of non-performance, whether such agreements be intended to facilitate the recovery of damages (liquidated damages according to the common law) or to operate as a deterrent against non-performance (penalty clauses proper), or both.

**2. Agreed payment for non-performance in principle valid**

National laws vary considerably with respect to the validity of the type of clauses in question, ranging from their acceptance in the civil law countries, with or without the possibility of judicial review of particularly onerous clauses, to the outright rejection in common law systems of clauses intended specifically to operate as a deterrent against non-performance, i.e. penalty clauses.

In view of their frequency in international contract practice, paragraph (1) of this Article in principle acknowledges the validity of any clauses providing that a party who does not perform is to pay a specified sum to the aggrieved party for such non-performance, with the consequence that the latter is entitled to the agreed sum irrespective of the harm actually suffered by it. The non-performing party may not allege that the aggrieved party sustained less harm or none at all.



### Illustration

1. A, a former international football player from country X, is recruited for three years to train the players of B, a football team from country Y, at a monthly salary of AUD 10,000. Provision is made for a severance allowance of AUD 200,000 in the event of unjustified dismissal. A is dismissed without any justification after six months. A is entitled to the agreed sum, even though A was immediately recruited by another team at double the salary received from B.

Normally, the non-performance must be one for which the non-performing party is liable, since it is difficult to conceive a clause providing for the payment of an agreed sum in case of non-performance operating in a force majeure situation. Exceptionally, however, such a clause may be intended by the parties also to cover non-performance for which the non-performing party is not liable.

In the case of partial non-performance, the amount may, unless otherwise agreed by the parties, be reduced in proportion.

### 3. Agreed sum may be reduced

In order to prevent the possibility of abuse to which such clauses may give rise, paragraph (2) of this Article permits the reduction of the agreed sum if it is grossly excessive “in relation to the harm resulting from the non-performance and to the other circumstances”. The same paragraph makes it clear that the parties may under no circumstances exclude such a possibility of reduction.

The agreed sum may only be reduced, but not entirely disregarded as would be the case were the judge, notwithstanding the agreement of the parties, to award damages corresponding to the exact amount of the harm. It may not be increased, at least under this Article, where the agreed sum is lower than the harm actually sustained (see however Comment 4 on Article 7.1.6). It is moreover necessary that the amount agreed be “grossly excessive”, i.e. that it would clearly appear to be so to any reasonable person. Regard should in particular be had to the relationship between the sum agreed and the harm actually sustained.

### Illustration

2. A enters into a contract with B for the purchase of machinery which provides for payment in five instalments of EUR 50,000 each. The contract contains a clause allowing immediate termination in the event of non-payment by A of one instalment, and authorises B to keep the sums already paid and to recover future instalments as damages. A fails to pay the third instalment. B keeps the EUR 100,000 already paid and claims, in addition to the return of the

machinery, the EUR 150,000 representing the three outstanding instalments. The court will reduce the amount since A's non-performance would result in a grossly excessive benefit for B.

#### **4. Agreed payment for non-performance to be distinguished from forfeiture and other similar clauses**

The type of clauses dealt with in this Article must be distinguished from forfeiture and other similar clauses which permit a party to withdraw from a contract either by paying a certain sum or by losing a deposit already made. On the other hand a clause according to which the aggrieved party may retain sums already paid as part of the price falls within the scope of this Article.

#### **Illustrations**

3. A undertakes to sell real estate to B for EUR 450,000. B must exercise the option to purchase within three months and must pay a deposit of EUR 25,000, which A is entitled to retain if B does not exercise the option. Since this is not an agreed payment for non-performance it does not fall under this Article and the sum cannot be reduced thereunder even if grossly excessive in the circumstances.

4. A enters into a contract with B for the lease of a machine. The contract provides that in the event of A's failure to pay one single rental the contract will be terminated and that the sums already paid will be retained by B as damages. The clause falls under this Article and the agreed amount may be subject to reduction.

## CHAPTER 8

### SET-OFF

#### ARTICLE 8.1

*(Conditions of set-off)*

**(1) Where two parties owe each other money or other performances of the same kind, either of them (“the first party”) may set off its obligation against that of its obligee (“the other party”) if at the time of set-off,**

**(a) the first party is entitled to perform its obligation;**

**(b) the other party’s obligation is ascertained as to its existence and amount and performance is due.**

**(2) If the obligations of both parties arise from the same contract, the first party may also set off its obligation against an obligation of the other party which is not ascertained as to its existence or to its amount.**

#### COMMENT

##### 1. Use of set-off

Under the Principles, when two parties owe each other an obligation arising from a contract or any cause of action, each party may set off its obligation against the obligation of the other party. By mutual deduction, both obligations are discharged up to the amount of the lesser obligation (see Article 8.5). Set-off avoids the need for each party to perform its obligation separately.

The obligor from whom payment is asked, and who sets off its own obligation, is called “the first party”. The obligee who first asks its obligor for payment and against whom the right of set-off is exercised, is called “the other party”.

**Illustrations**

1. A, a sea carrier, has carried goods belonging to B from country X to country Y. A asks B for EUR 10,000 as payment for the carriage. B, who had previously become an obligee of A for an amount of EUR 10,000 as compensation for harm to other goods carried, may set off its own obligation to pay A EUR 10,000 against A's obligation to pay it EUR 10,000. If it does so, neither A nor B will remain the other's obligor.
2. A sells B a plot of land for the price of AUD 100,000. Subsequently B, who is a contractor, builds a house for A. The price of the construction is AUD 200,000. When A asks for the payment of the land, B may set off the price of the construction. The obligation of B to pay A AUD 100,000 is totally discharged, but A remains B's obligor for AUD 100,000.

For a party to be allowed to set off its own obligation against the obligation of the other party the conditions laid down in this Article must be satisfied.

**2. Obligation owed to each other**

A first condition is that each party is the obligor and the obligee of the other (paragraph (1), opening sentence). To be noted is that the parties must be so in the same capacity. Thus, set-off is not possible if the first party has an obligation to the other party in its own name but is the obligee of the other party in another capacity, for example as a trustee or as the absolute owner of a company.

**Illustration**

3. Company A sells company B machinery for 600,000 Japanese Yen (JPY). B, which is in business with company C, a subsidiary of A, sells C products for JPY 500,000. When A asks B to pay the sales price of the machinery, B cannot set off its obligation for the sale of the products to C, even if the capital of C is totally subscribed by A, as C is an independent entity. A and B are not obligor and obligee of each other.

The condition that the obligations must be owed to each other may give rise to a problem where the other party has assigned the obligation owed to it by the first party to a third party. The first party may nonetheless set off its obligation against the other party's obligation if the right of set-off existed against the assignor's obligation before the assignment was notified to the obligor (see Article 9.1.13).

### 3. Obligations of the same kind

Both obligations must be of the same kind (paragraph (1), opening sentence). In some legal systems obligations have to be “fungible”. A monetary obligation may be set off only against a monetary obligation. A delivery of grain may be set off only against a delivery of grain of the same kind.

The concept of “obligations of the same kind” is broader than that of “fungible obligations”. Performances of non-monetary obligations may be of the same kind while at the same time not being fungible. Two obligations to deliver wine of the same vineyard but not of the same year may be obligations of the same kind, but would not be fungible. Cash and securities are not performances of the same kind in the sense of this Article. Nevertheless, as is the case with different foreign currencies, set-off may be exercised if the securities are easily convertible and if there is no agreement to the effect that only the payment of specified cash or securities is possible. Whether or not obligations are of the same kind may depend on commercial practices or special trade rules.

A personal obligation cannot be of the same kind as another type of obligation. Set-off is thus not available if one of the obligations is of a personal nature.

#### Illustrations

4. A, a crude oil producer, contracts to deliver 1,500 tonnes of crude oil by pipe-line every month to B in country X. B, in turn, must each week transfer 1,000 tonnes of crude oil by road. The crude oil produced by A and the crude oil delivered by B do not have the same origin and are not totally similar, but as their use could be identical, the two obligations relating to the crude oil can be said to be of the same kind, and if A and B are obligor and obligee for the delivery of some quantity of crude oil, set-off will be available.

5. A holds 100 ordinary shares of the company C. Shareholder B of the same company holds 120 redeemable preferred shares. They are obligee and obligor of each other, and in an earlier contract it was provided that payment would be possible by means of shares of equal value. Since the shares held by A and the shares held by B are not of the same kind, set-off cannot be exercised.

### 4. First party's obligation performable

The first party must have the right to perform its obligation (paragraph (1)(a)). It cannot impose on the other party a performance which either has not yet been ascertained, or is not yet due.

**Illustrations**

6. A has sold ten trucks to B for USD 1,000,000. B must pay for the trucks before 30 September. B wishes to set off an obligation it has towards A arising from a loan to A, repayment of which is due on 30 November. Before this date B may not set off its obligation towards A, as it cannot pay A before 30 November. B's obligation to A is not yet due.

7. A owes B EUR 200,000 for the repayment of a loan. The repayment must take place on 30 January. B is obliged to pay A for a claim for damages of EUR 140,000, under a judgment handed down on 25 January. A asks B to pay on 9 February. B, whose obligation can be performed, is allowed to set off its obligation against A's obligation.

8. A has sold B 10,000 bottles of wine, the price of which must be paid at the latest on 30 October. B is also A's obligee and A's obligation is already due. B may set off its own obligation against A's obligation on 10 October even if the latest date B's obligation should be paid is 30 October, because A is bound to accept a payment before such date.

**5. Other party's obligation ascertained**

Set-off may be exercised only when the other party's obligation is ascertained both as to its existence and as to its amount (paragraph (1)(b)).

The existence of an obligation is ascertained when the obligation itself cannot be contested, for example, when it is based on a valid and executed contract or a final judgment or award which is not subject to review.

Conversely, an obligation to pay damages is not ascertained when the obligation may be contested by the other party.

Even if the existence of the other party's obligation is not contested, it is not possible to exercise set-off if the obligation is not ascertained as to its amount. If the existence of the harm is not disputed, but the amount of the compensation has not been fixed, set-off will not be available.

**Illustrations**

9. A judgment requires A to pay B 200,000 Chinese Yuan Renminbi (CNY), for breach of contract. B is in turn A's obligor for the repayment of a loan of CNY 240,000, repayment of which is already due. A asks B to pay the CNY 240,000. B may set off its obligation against A's obligation arising from the judgment.

10. A sells B a yacht for EUR 300,000. A is liable to B for tort. The harm is not contested, but the amount of damages has not yet been fixed. A will not be permitted to set off its own obligation, as A's obligation has not been ascertained.

The Principles do not deal with the impact of insolvency proceedings on the right to exercise set-off, which is therefore to be determined by the applicable law. Most domestic laws grant the first party the right to exercise set-off even after the other party has become involved in insolvency proceedings, thereby derogating from the principle of the equality of the creditors in insolvency proceedings.

## **6. Other party's obligation due**

The other party's obligation must furthermore be due (paragraph (1)(b)). An obligation is due when the obligee has the right to request performance by the obligor, and the obligor has no available defence against that request. A defence will, for example, be available if the time of payment has not yet arrived. As a natural or moral obligation is not enforceable, the first party may not set off its obligations against such an obligation owed by the other party. The enforceability or non-enforceability of an obligation may depend on the otherwise applicable law. Consequently, in some cases the possibility to exercise the right of set-off may depend on the otherwise applicable law.

### **Illustration**

11. By a final judgment of 10 April, A was ordered to pay B USD 20,000 for the sale of cotton. A, who is B's obligee for the repayment of a loan of USD 12,000 which was enforceable as from 10 January, may set off its own obligation against B's obligation. B, whose obligation is ascertained and due cannot contest the set-off exercised by A.

Since the expiration of the limitation periods prevents the enforcement of the obligation but does not extinguish the right itself, the first party who is not allowed to enforce the time-barred obligation may nonetheless set off that time-barred obligation (see Article 10.10).

## **7. Set-off of obligations arising from the same contract**

Set-off is a convenient means of discharging obligations at once and at the same time. Therefore, if the two obligations arise from the same contract, the conditions of set-off are modified.

If the obligations of the two parties arise from the same contract, the first party is allowed to set off its own obligation against an obligation of the other party even where that other party's obligation is not

ascertained as to its existence or to its amount (paragraph (2)). Thus, for instance, an obligation to pay damages may be ascertained as to its existence but not as to its amount. If the minimum amount payable cannot be contested, the first party may set off its own obligation up to that minimum amount, even if the total amount of the other party's obligation is unknown.

Even though one of the obligations is contested, the right to set-off can be exercised because all the relevant obligations capable of being set off arise from the same contract and can therefore be easily identified. This could be useful to parties in a business relationship to facilitate quick settlements of claims. Judicial intervention may however be necessary to determine whether the conditions of set-off are in fact satisfied. In international commerce, the obligations of the two parties may frequently arise from the same contract.

### **Illustrations**

12. A carries turkeys for B from country X to country Y. The carriage charge is 35,000 Russian Roubles (RUB). During the carriage one hundred turkeys die due to the fault of the carrier which it acknowledges. A asks B for the payment of the carriage. B may set off the obligation to pay for the harm caused by the loss of the turkeys against A's obligation. Although the amount of the damages is not ascertained, it would be easy to estimate the damages and determine if the conditions for set off are satisfied as the two obligations arise from the same contract.

13. A, a carrier, accepts to carry a piano for pianist B from country X to country Y. A provision of the contract expressly provides that delay penalties are to be paid if the piano is not delivered at the concert hall five days before the date of the concert. The piano is delivered at the place of destination only two days before the date of the concert. A asks for the payment of the carriage. B may set off its claim for the agreed delay penalties against A's claim even if A contests the amount of the penalties owed for the delay.

## **8. Set-off by agreement**

Even if the conditions of this Article are not met, the parties may achieve the effects of set-off by agreement. Likewise, parties may agree that their mutual obligations are set off automatically either at a specific date or periodically. Also, more than two parties may agree that their respective obligations shall be discharged, for example by netting.



**ARTICLE 8.2***(Foreign currency set-off)*

**Where the obligations are to pay money in different currencies, the right of set-off may be exercised, provided that both currencies are freely convertible and the parties have not agreed that the first party shall pay only in a specified currency.**

**COMMENT****1. Convertible currencies**

Payments in different currencies are not performances of the same kind as required by Article 8.1. However, if the payments are to be made in currencies that are both convertible, set-off may nevertheless be exercised. According to Article 6.1.9, if there is no agreement to the contrary, payment may be made by the obligor in the currency of the place for payment, if this currency is convertible. On the contrary, since the relative value of a currency that is not freely convertible cannot be readily ascertained for the purpose of set-off, set-off cannot be used to impose payment in such a currency on the other party.

**Illustration**

1. A, a wine producer in country X, sells 5,000 bottles of wine for USD 200,000 to B, a cork producer. B sells 100,000 corks to A for the price of 100,000 livres, which is the currency of the country where corks are produced and which is not convertible. A asks B for payment of the USD 200,000. B may not set off the 100,000 livres against the USD 200,000.

**2. Currency specified by contract**

If a contract expressly requires a party to pay in a specified currency, and if the other party has to perform its own obligation in a currency different from that currency, it will not be able to set off its own obligation against the other party's obligation.

**Illustration**

2. A sells B products for USD 100,000. The sales contract expressly provides that the price is to be paid by the buyer in US dollars. B, an Asian carrier, is A's obligee for an unpaid invoice for carriage charges which must be paid in Korean Won. A requires payment of the USD 100,000. B, who contractually is obliged to pay the price of the products in US dollars, is not allowed to set off its obligation against the obligation of A to pay the carriage charges.

**ARTICLE 8.3**

*(Set-off by notice)*

**The right of set-off is exercised by notice to the other party.**

**COMMENT**

The right of set-off is exercised by notice to the other party. It does not operate automatically or by declaration of the court. The first party must inform the other party that it will discharge its own obligation by set-off. Notice must not be conditional.

To be effective, notice must be sent after the conditions for set-off are fulfilled.

Notice may be given by any means appropriate to the circumstances and is effective when it reaches the person to whom it is given (see Article 1.10).

**ARTICLE 8.4**

*(Content of notice)*

**(1) The notice must specify the obligations to which it relates.**

**(2) If the notice does not specify the obligation against which set-off is exercised, the other party may, within a reasonable time, declare to the first party the obligation to which set-off relates. If no such declaration is made, the set-off will relate to all the obligations proportionally.**

**COMMENT**

According to paragraph (1), the notice must specify the obligations of both parties that are to be set off. The other party, receiving the notice, must know the grounds for set-off and the amount of set-off.

**1. Declaration by the other party**

If the first party has two or more obligations against the other party, and if the first party has not specified the obligations it wants to be paid by set-off, the other party may freely choose which of the first party's obligations it wants to be discharged (paragraph (2), first part).

**Illustration**

1. A regularly sells B cloth. On 30 December B asks A for the payment of USD 50,000 that A owes it. At that date B owes A the payment of the price relating to three different sales contracts, i.e. USD 40,000, USD 35,000 and USD 45,000 respectively. If A wants to set off B's obligation, it has to indicate in the notice which of the three obligations owed by B it wants to set off. If A does not indicate in the notice which obligation owed by B it wants to set off, B may in a reasonable time indicate to A that its obligation of USD 45,000 will be totally discharged by set off and that the obligation of USD 35,000 will be discharged up to USD 5,000. After set-off has been applied, B remains the obligor of A for USD 70,000.

**2. Absence of declaration**

If the notice does not specify the obligations that the first party wants to set off, and if the other party does not make any declaration as to which obligation set-off relates within a reasonable time, all the obligations of the other party will be discharged by set-off proportionally, up to the value of the first party's obligation (paragraph (2), second part).

**Illustration**

2. The facts are the same as in Illustration 1, except that B does not declare to which obligation set-off relates. In the absence of such a declaration, set-off will discharge the obligation of USD 40,000 of the first contract up to USD 16,670; the obligation of USD 35,000 of the second contract up to USD 14,580 and the obligation of USD 45,000 of the third contract up to USD 18,750.

**ARTICLE 8.5**  
*(Effect of set-off)*

- (1) Set-off discharges the obligations.**
- (2) If obligations differ in amount, set-off discharges the obligations up to the amount of the lesser obligation.**
- (3) Set-off takes effect as from the time of notice.**

**COMMENT****1. Discharge by set-off**

If the conditions of set-off specified in Article 8.1 are satisfied, the obligations of both parties are discharged to the extent of the set-off, as if two reciprocal payments had been made.

**Illustration**

- 1. A owes USD 100,000 to B and B owes USD 100,000 to A. B asks for the payment of its obligation. A by notice declares to B that it sets off its own obligation. After set-off takes effect, the two obligations are discharged.

If the two obligations differ in their amount, set-off will discharge the obligations, but only up to the amount of the lesser obligation.

**Illustration**

- 2. B owes USD 100,000 to A, who in turn owes B USD 70,000. A asks for the payment of the USD 100,000 it is owed, B declares that it wants to set off A's obligation of USD 70,000. If the conditions for set-off are met, A is no longer the obligor of B, as its obligation has been entirely discharged, but A is still the obligee of B for USD 30,000, corresponding to the part of the obligation not paid by set-off.

**2. Set-off effective at the time of notice**

The obligations are discharged at the time of notice if at that time the conditions required for set-off are fulfilled. Set-off does not operate retroactively. It has prospective effect only.

The date of effectiveness of set-off is consistent with the necessity to declare set-off by notice, and in practice the date when set-off is effective will be easy to know.

The situation has to be evaluated as if both obligations were paid at the time of notice. Two consequences derive from this rule. Firstly, interest on the obligations runs until the time of notice. A party who may and wants to set off its obligation, must declare set-off as soon as possible if it wishes to stop the accrual of interest. Secondly, if an undue payment has been made after set-off has been declared, restitution will take place, as the payment has no legal grounds. If the payment had been made before the notice, it is an effective payment and restitution cannot be required.

#### Illustration

3. A owes B USD 100,000 dollars for goods sold by B. A's obligation is ascertained and payment is due on 20 November. By a judgement dated 30 November, B is ordered to pay A USD 80,000 in damages. The obligation to pay USD 80,000 is due and ascertained at the date of the judgement, i.e. on 30 November. Set-off is exercised by A by notice on 10 December. The set-off will take place at the time of notice as all the conditions required have been satisfied before this date. The two obligations are discharged up to the amount of the lesser obligation. A will remain the obligee of B for USD 20,000. After 10 December, interest no longer accrues, except on the amount of USD 20,000.

At the time when the conditions for set-off are satisfied and notice has been given, not only are the principal obligations discharged but also related rights, e.g. rights securing an obligation, are discharged accordingly.

#### Illustration

4. A, a banker, had lent architect B EUR 100,000 and has obtained a personal security for the payment from B's wife. B is the obligee of A for EUR 120,000, which is money that B holds on its account in A's bank. A asks B for the payment of the EUR 100,000. B declares set-off by notice on 12 December. The conditions required for A's obligation and B's obligation were fulfilled on 10 December. At the date of notice on 12 December, A's and B's obligations are discharged, as is the personal security given by B's wife.

## CHAPTER 9

# ASSIGNMENT OF RIGHTS, TRANSFER OF OBLIGATIONS, ASSIGNMENT OF CONTRACTS

## SECTION 1: ASSIGNMENT OF RIGHTS

### ARTICLE 9.1.1

*(Definitions)*

**“Assignment of a right” means the transfer by agreement from one person (the “assignor”) to another person (the “assignee”), including transfer by way of security, of the assignor’s right to payment of a monetary sum or other performance from a third person (“the obligor”).**

#### COMMENT

In many circumstances an obligee entitled to the payment of a monetary sum or to another performance from an obligor may find it useful to assign its right to another person. For instance, an assignment to a bank is a common way to finance the credit granted to a customer. The Articles of the present Section cover the assignment of rights as defined in this Article.

#### 1. Transfer by agreement

Only transfers by agreement are concerned, as opposed to situations in which the applicable law may provide for legal transfers of certain rights (such as, in certain jurisdictions, the transfer of a seller’s rights against an insurer to the purchaser of an insured building, or the automatic transfer of rights in the case of the merger of companies (see Article 9.1.2(b))).

The definition equally does not cover unilateral transfers, which in certain jurisdictions may take place without the assignee’s participation.

**2. Right to payment of a monetary sum or to other performance**

On the other hand, the definition is not restricted to the assignment of rights to the payment of a monetary sum. It also covers rights to other kinds of performance, such as the rendering of a service. Nor are the assignable rights limited to rights of a contractual nature. Claims deriving from non-contractual claims or based on a judgment, for instance, can be governed by the present Section, subject to Article 1.4. Future rights may also be transferred under the conditions of Article 9.1.5.

**3. Notion of “transfer”**

The “transfer” of the right means that it leaves the assignor’s assets to become part of those of the assignee. The definition also covers transfers for security purposes.

**4. Third party rights**

Transfers from the assets of the assignor to those of the assignee remain subject to third party rights. Different third persons can be affected by the assignment of a right between an assignor and an assignee, such as, first and foremost, the obligor, but also the assignor’s creditors and successive assignees. Third party rights are covered in part by other provisions of this Section (see Articles 9.1.10 and 9.1.11 concerning the obligor and successive assignees). They may in some instances be governed by mandatory rules of the otherwise applicable law (e.g. the law of bankruptcy).

**ARTICLE 9.1.2***(Exclusions)*

**This Section does not apply to transfers made under the special rules governing the transfers:**

**(a) of instruments such as negotiable instruments, documents of title or financial instruments, or**

**(b) of rights in the course of transferring a business.**

**COMMENT**

Some types of assignment of rights are normally subject to very specific rules under the applicable law, and are therefore not governed by this Section.

**1. Transfer of instruments governed by special rules**

The transfer of certain types of instrument governed by special rules are outside the scope of this Section. This applies for instance to negotiable instruments, such as bills of exchange, that are usually transferred by endorsement or delivery of the document, and which are subject to further distinct rules, e.g. concerning defences that would have been available to the transferor. This exclusion also applies to documents of title, such as bills of lading or warehouse receipts, and financial instruments such as stocks and bonds. The transfer of such instruments are all normally subject to specific rules.

This does not exclude the possibility that such rights, in certain jurisdictions, could also be transferred by a normal assignment, which would then be subject to this Section.

**2. Transfer of a business**

Another exclusion is assignment made in the course of transferring a business under special rules governing such transfers, as may happen in the case of the merger of companies. The applicable law often provides for mechanisms that cause all rights and obligations, under certain conditions, to be transferred in their entirety by operation of law.

Article 9.1.2(b) does not prevent this Section from applying when certain rights pertaining to the transferred business are assigned individually. On the contrary, the mere transfer of shares in a company may fall under Article 9.1.2(a) and therefore not be covered by this Section.

**Illustrations**

1. Company A is transferred to company B. If the otherwise applicable law provides that all rights pertaining to the former company are automatically transferred to the latter, the Principles do not apply.
2. The initial facts are the same as in Illustration 1, but B is not interested in taking over a specific claim against customer X, and prefers that right to be assigned to company C. This particular transfer is subject to the Principles.



**ARTICLE 9.1.3***(Assignability of non-monetary rights)*

**A right to non-monetary performance may be assigned only if the assignment does not render the obligation significantly more burdensome.**

**COMMENT**

The assignment of a right does not in principle affect the obligor's rights and obligations. However, to a certain extent the fact that performance is now due to another obligee can modify the conditions under which the obligation is to be performed. The place of performance may be different. The change of obligee may in itself render the obligation more burdensome.

Article 9.1.8 entitles the obligor to be compensated by the assignor or the assignee for any additional costs caused by the assignment. That provision should be sufficient to take care of the problem in the case of the assignment of monetary obligations. However, when the assigned right concerns a non-monetary performance, the remedy may not always be sufficient. This Article excludes the possibility of assigning such rights when the transfer would render the obligation significantly more burdensome for the obligor.

**Illustrations**

1. Company X has undertaken to provide the security service aimed at preventing theft in warehouses used by company A for the storage of wood. The premises are sold to company B, which intends to apply them to the same use. Nothing in this provision prevents A from assigning to B its right to the security services provided by X.
2. The initial facts are the same as in Illustration 1, but B intends to use the warehouses for the storage of electronic equipment. A's right to the security services provided by X may not be assigned to B: such services would become significantly more burdensome since the security risks are obviously much higher with electronic equipment than with the storage of wood.

**ARTICLE 9.1.4***(Partial assignment)*

**(1) A right to the payment of a monetary sum may be assigned partially.**

**(2) A right to other performance may be assigned partially only if it is divisible, and the assignment does not render the obligation significantly more burdensome.**

**COMMENT****1. Economic interest**

The partial assignment of a right may serve different economic purposes. A contractor may for instance want to assign part of its right to payment from a customer to a financing institution and keep the rest for itself. Or it may want to assign the other part to a supplier of raw materials.

Permitting partial assignment may however affect the principle that the assignment should not worsen the obligor's situation. If the right is split, the obligor will have to perform in several parts, which could entail extra costs.

**2. Monetary and non-monetary rights**

The obligor's burden of having to make two or several monetary payments instead of one is not in itself deemed to be excessive, and partial assignments of monetary rights are therefore permitted in principle (paragraph (1)).

Another rule prevails for the assignment of non-monetary rights, where the validity of the partial assignment is made dependent on two cumulative conditions: the divisibility of the performance due and the degree of additional burden the partial assignment may place on the obligor. Article 9.1.3 already excludes the possibility to assign non-monetary rights in their entirety if the assignment would render the obligation significantly more burdensome. Paragraph (2) applies the same rule to the partial assignment of such rights.

In any event, additional costs borne by the obligor as a result of having to perform in several parts must be compensated under Article 9.1.8.

## Illustrations

1. Buyer X is due to pay a price of USD 1,000,000 to seller A on 31 October. A urgently needs USD 600,000 and assigns a corresponding part of its right to bank B. Notice of the partial assignment is given to X. On 31 October, both A and B claim payment of their respective parts. X must pay A USD 400,000 and B USD 600,000.
2. Metal company X is to deliver 1,000 tons of steel to carmaker A on 31 October. Due to a decrease in sales, A estimates that it will not need that much steel at that time, and assigns the right to delivery of up to 300 tons to carmaker B. Notice of the partial assignment is given to X. On 31 October both A and B claim delivery of their respective quantities. X must deliver 700 tons to A and 300 tons to B.
3. Tax consultant X has promised to spend 30 days in examining the accounts of company A in order to determine the proper policy to be followed in the light of new tax regulations. A subsequently regrets this arrangement, in consideration of the level of the fees to be paid. It proposes to assign 15 of the days to company B. X can argue against such a partial assignment on the grounds that performance of tasks of that nature is not divisible. It can also argue that the accounts of B are of a significantly more complex nature than those of A.

**ARTICLE 9.1.5***(Future rights)*

**A future right is deemed to be transferred at the time of the agreement, provided the right, when it comes into existence, can be identified as the right to which the assignment relates.**

**COMMENT****1. Economic interest**

For the purposes of this Section, a future right is a right that will or might come into existence in the future (as opposed to a present right to a performance due in the future). Examples of future rights are rights that a bank may have against a customer who might be granted a credit line in the future, or that a company may have against another

company on the basis of a contract which might be concluded in the future. The assignment of such future rights can be highly significant economically.

## **2. Determinability**

According to this Article a future right can be assigned on condition that it can be determined as the right to which the assignment relates when it comes into existence. The reason for this is the need to avoid the difficulties that might be caused by a transfer of future rights that are described in vague and too broad general terms.

## **3. Retroactive effect**

This Article also provides that the assignment of future rights is effective with retroactivity between the assignor and the assignee. When the right comes into existence, the transfer is considered to have taken place at the time of the assignment agreement.

As regards third parties, it will be recalled that their rights may in some instances be governed by mandatory rules of the otherwise applicable law (e.g. the law of bankruptcy). However, third party rights are partly covered by other provisions of this Section, including the consequences of notices specified in Articles 9.1.10 and 9.1.11.

### **Illustration**

In order to finance new investments, company A assigns the royalties to be earned from future licences of a certain technology to lending institution B. Six months later, A licenses that technology to company X. The royalties due are considered to have been assigned to B from the date of the assignment agreement, provided the royalties can be related to this agreement.

### **ARTICLE 9.1.6**

*(Rights assigned without individual specification)*

**A number of rights may be assigned without individual specification, provided such rights can be identified as rights to which the assignment relates at the time of the assignment or when they come into existence.**

**COMMENT**

Rights are often assigned as a bundle or in bulk. A company may for instance assign all its receivables to a factoring company. In practice it would be excessively burdensome to require individual specification of each assigned right, but the global identification of the rights assigned as a bundle must be such as to permit the recognition of each right concerned as part of the assignment.

In the case of existing rights, such recognition must be possible at the time of the assignment. If future rights are included in the bundle, in accordance with Article 9.1.5 identification must be possible when the rights come into existence.

**Illustration**

Retailer A assigns all its receivables to factor B. There are thousands of existing and/or future rights. The assignment does not require the specification of each single claim. Later, B gives notice of the assignment to the obligor of a specific receivable. B must be able to demonstrate the inclusion of that receivable in the bundle either at the time of the assignment, or, in the case of a right which did not exist yet at that time, when the right came into existence.

**ARTICLE 9.1.7**

*(Agreement between assignor  
and assignee sufficient)*

**(1) A right is assigned by mere agreement between the assignor and the assignee, without notice to the obligor.**

**(2) The consent of the obligor is not required unless the obligation in the circumstances is of an essentially personal character.**

**COMMENT**

In the definition of Article 9.1.1 the assignment of a right is described as a “transfer by agreement”. Articles 9.1.7 to 9.1.15 govern the respective legal positions of assignor, assignee and obligor.

**1. Mere agreement between assignor and assignee**

According to paragraph (1) of this Article, the assignment of a right is effective, i.e. the right is transferred from the assignor's assets to the assignee's assets, by mere agreement between these two parties. The provision is an application to the assignment of a right of the general principle laid down in Article 1.2 according to which nothing in the Principles requires a contract to be concluded in a particular form. Yet it does not affect the possible application of mandatory rules of the otherwise applicable law according to Article 1.4: thus, for instance, an assignment for security purposes may be subject to special requirements as to form.

As already stated in Comment 4 on Article 9.1.1, the rule laid down in paragraph (1) remains subject to third party rights, which are partly covered by other provisions of this Section (see Articles 9.1.10 and 9.1.11 concerning the obligor and successive assignees), and may in some instances be governed by mandatory rules of the otherwise applicable law (e.g. the law of bankruptcy) according to Article 1.4. However, it should be stressed that notice to the obligor as provided for by Article 9.1.10 is not a condition for the effectiveness of the transfer of the right(s) between the assignor and the assignee.

**2. Consent of the obligor in principle not required**

Paragraph (2) states explicitly what is already implied in paragraph (1), i.e. that the obligor's consent is not required for the assignment to be effective between the assignor and the assignee.

**3. Exception: obligation of an essentially personal character**

An exception is made for the case in which the right to be assigned relates to an obligation of an essentially personal character, i.e. a right that has been granted by the obligor specifically to the person of the obligee. This characteristic prevents the right from being assigned without the consent of the obligor, since it would be inappropriate to oblige the obligor to perform in favour of another person.

**Illustrations**

1. Company X promises to sponsor activities organised by organisation A, engaged in the defence of human rights. A wishes to assign the right to organisation B, active in the protection of the environment. The assignment can only take place with X's agreement.

2. A famous soprano has made a contract with agent A to sing in concerts organised by A. A sells its claims against the soprano to agent B. This transfer will require the soprano's consent, if the circumstances reveal that she was willing to sing only for A.

#### **4. Effect of other provisions**

The possibility to assign a right without the obligor's consent may be affected by the presence of a non-assignment clause in the contract between the assignor and the obligor (see Article 9.1.9), although such a clause does not in itself necessarily imply the essentially personal character of the obligation.

This Article does not address the issue of the necessity to give notice of the assignment to the obligor in order to avoid that the obligor pay the assignor after the assignment has taken place. On these issues, see Articles 9.1.10 and 9.1.11.

#### **ARTICLE 9.1.8**

*(Obligor's additional costs)*

**The obligor has a right to be compensated by the assignor or the assignee for any additional costs caused by the assignment.**

#### **COMMENT**

##### **1. Compensation for additional costs**

The assignment of a right does not necessarily affect the obligor's rights and obligations. However, should the obligor bear additional costs due to the fact that performance has to be rendered to the assignee instead of the original obligee, this Article entitles the obligor to require due compensation.

#### **Illustration**

1. Company X is obliged to reimburse a loan of EUR 1,000,000 to company A. Both companies are located in country M. A assigns its right to company B, located in country N. X has a right to be compensated for the additional costs involved in what has now become an international transfer.

The rule laid down in this Article is in conformity with Article 6.1.6, which provides a similar solution if a party to the contract changes its place of business after the conclusion of the contract.

## **2. Compensation by the assignor or the assignee**

The obligor may claim compensation for additional costs either from the assignor or from the assignee. In the case of a monetary obligation, the obligor will often be in a position to set off its right to compensation against the obligation it owes to the assignee.

## **3. Partial assignment**

Additional costs may arise in particular in the case of partial assignment (see Article 9.1.4). This Article applies accordingly.

### **Illustration**

2. In Illustration 2 to Article 9.1.4, A has assigned to B part of its right to receive a delivery of steel from X. Instead of having to deliver 1,000 tons to A, X became obliged to deliver 700 tons to A and 300 tons to B. X is entitled to be compensated for the additional costs resulting from having to deliver in two parts.

## **4. Obligation becoming significantly more burdensome**

In two cases compensation for additional costs is not considered to be a sufficient remedy. Firstly, under Article 9.1.3 the assignment of a right to a non-monetary performance is not allowed when it would render the obligation significantly more burdensome. Secondly, under Article 9.1.4 the partial assignment of a right to a non-monetary performance is also not allowed in similar circumstances.

### **ARTICLE 9.1.9**

*(Non-assignment clauses)*

**(1) The assignment of a right to the payment of a monetary sum is effective notwithstanding an agreement between the assignor and the obligor limiting or prohibiting such an assignment. However, the assignor may be liable to the obligor for breach of contract.**



**(2) The assignment of a right to other performance is ineffective if it is contrary to an agreement between the assignor and the obligor limiting or prohibiting the assignment. Nevertheless, the assignment is effective if the assignee, at the time of the assignment, neither knew nor ought to have known of the agreement. The assignor may then be liable to the obligor for breach of contract.**

## COMMENT

### 1. Balance of interests

According to Article 9.1.7(2) the consent of the obligor is not required for the assignment to be effective between the assignor and the assignee unless the obligation is of an essentially personal character. However, in practice it is frequent for the contract between the original obligee/assignor and the obligor to contain a clause limiting or prohibiting the assignment of the original obligee/assignor's rights as the obligor may not wish to change obligee. Should the original obligee/assignor subsequently assign such rights in spite of the non-assignment clause, the conflicting interests of the obligor and of the assignee must be weighed. The obligor suffers a violation of its contractual rights, but the assignee must equally be protected. At a more general level, it is also important to favour the assignment of rights as an efficient means of financing.

In this respect this Article makes a distinction between the assignment of monetary rights and the assignment of rights to other performances.

### 2. Monetary rights

In the case of the assignment of monetary rights, paragraph (1) gives preference to the needs of credit. The assignee of a monetary right is protected against non-assignment clauses and the assignment is fully effective. However, as the assignor acts contrary to its contractual duties, it is liable in damages to the obligor for non-performance of the contract under Chapter 7, Section 4.

## Illustrations

1. Contractor A is entitled to the payment of USD 100,000 from its customer X after a certain stage of construction work has been completed. The contract contains a clause prohibiting A from

assigning the right. A nevertheless assigns the right to bank B. B can rely on the assignment despite the clause, and can claim payment when it is due. X is however entitled to sue A for acting in breach of the clause. X could for instance claim damages if it demonstrates that it has suffered some prejudice.

2. Company X is to reimburse EUR 500,000 to company A at a date when it can set off this obligation partially with a claim of EUR 200,000 it has against A. The contract between X and A contains a non-assignment clause. Disregarding that clause, A assigns its right to reimbursement to company B. X may claim damages against A for the costs it incurs in having to engage in a separate procedure to recover the sum of EUR 200,000.

### **3. Non-monetary rights**

The assignment of rights to non-monetary performances does not have the same relationship to credit, thus justifying another solution which is to be found in paragraph (2). In order to achieve a fair balance between the conflicting interests of the three parties concerned, the rule is that non-assignment clauses are given effect vis-à-vis the assignee with the result that the assignment is ineffective. The solution is however reversed if it can be established that, at the time of the assignment, the assignee did not know and ought not to have known of the non-assignment clause. In such a case, the assignment is effective, but the assignor may be liable in damages to the obligor for non-performance of the contract under Chapter 7, Section 4.

#### **Illustration**

3. Company X has agreed to communicate to company A all improvements it will develop to a technical process over a period of time. Their contract stipulates that A's rights towards X may not be assigned. A does not need the technology for itself any longer and attempts to assign its rights to company B. Such an assignment is ineffective. X does not become B's obligor. In such a case, B has a claim against A under Article 9.1.15(b).

**ARTICLE 9.1.10***(Notice to the obligor)*

**(1) Until the obligor receives a notice of the assignment from either the assignor or the assignee, it is discharged by paying the assignor.**

**(2) After the obligor receives such a notice, it is discharged only by paying the assignee.**

**COMMENT****1. Effect of notice on the obligor**

Whereas the assignment is effective between the assignor and the assignee as a result of their agreement (see Article 9.1.7), the obligor will be discharged by paying the assignor until it receives notice of the assignment. If the obligor pays the assignor, the assignee can recover that payment from the assignor (see Article 9.1.15(f)). Only after the obligor receives a notice of assignment does the assignment become effective towards the obligor. The obligor can then be discharged only by paying the assignee.

**Illustrations**

1. Seller A assigns its right to payment from buyer X to bank B. Neither A nor B gives notice to X. When payment is due, X pays A. This payment is fully valid and X is discharged. It will be up to B to recover it from A under Article 9.1.15(f).
2. Seller A assigns to bank B its right to payment from buyer X. B immediately gives notice of the assignment to X. When payment is due, X still pays A. X is not discharged and B is entitled to oblige X to pay a second time.

Before the obligor receives a notice of the assignment, it is discharged when it pays the assignor irrespective of whether it knew, or ought to have known, of the assignment. The purpose is to place the burden of informing the obligor of the assignment on the parties to the assignment agreement, i.e. the assignor and the assignee. This solution is considered to be justified in the context of international commercial contracts. However, it does not necessarily exclude that in certain circumstances the obligor will be liable for damages if it acted in bad faith when it paid the assignor.

Parties sometimes resort to so-called “silent assignments”, where the assignor and the assignee agree not to inform the obligor of the assignment. This arrangement is valid between parties, but since the obligor receives no notice, it will be discharged by paying the assignor, as provided in Article 9.1.10(1).

## **2. Meaning of “notice”**

“Notice” is to be understood in the broad sense of Article 1.10. Although this Article does not specify the content of the notice, the latter should indicate not only the fact of the assignment, but also the identity of the assignee, the specifications of the right transferred (subject to Article 9.1.6) and, in the case of partial assignment, the extent of the assignment.

## **3. Who should give notice**

Article 9.1.10(1) leaves the question of who should give notice open, i.e. whether it should be the assignor or the assignee. In practice, it is probable that in most cases the assignee will take the initiative, as it has a major interest in avoiding that the obligor will perform in favour of the assignor notwithstanding the assignment. But notice given by the assignor has the same effect. When notice is given by the assignee, the obligor may request adequate proof of the assignment (see Article 9.1.12).

## **4. When must notice be given**

This Article does not explicitly require notice to be given only after the assignment agreement has been concluded. In some cases the contract between a future assignor and the obligor will provide that the rights arising from it will be assigned to a financial institution. Whether this can be considered to be adequate notice having the consequences provided for in this Article is a matter of interpretation, and may possibly depend on the definiteness of the clause regarding the identity of the future assignee.

## **5. Revocation of notice**

Notice given to the obligor can be revoked in certain circumstances, e.g. if the assignment agreement itself becomes invalid, or if an assignment made for security purposes is no longer necessary. This will not affect payments made before the revocation to the person who was the assignee at the time, but if the obligor pays that person after the revocation it would no longer be discharged.

**ARTICLE 9.1.11**  
*(Successive assignments)*

**If the same right has been assigned by the same assignor to two or more successive assignees, the obligor is discharged by paying according to the order in which the notices were received.**

**COMMENT**

**1. Priority of first notice**

This Article deals with the case where the same assignor assigns the same right to different assignees. Normally this should not happen, although in practice it may occur, whether the assignor does so consciously or inadvertently. Preference is then given to the assignee who was the first to give notice. The other assignees can only claim against the assignor under Article 9.1.15(c) below.

**Illustration**

On 5 February seller A assigns its right to payment from buyer X to bank B, and then on 20 February to bank C. C notifies the assignment on 21 February, and B does so only on 25 February. X is discharged by paying C, even though the right was assigned to C after it had been assigned to B.

Unlike the solution prevailing under certain jurisdictions, this Article does not take into consideration the actual or constructive knowledge the obligor may have of the assignment(s) in the absence of notice. This approach is motivated by the wish to encourage the giving of notice, thus ensuring a degree of certainty that is especially advisable in the context of international contracts.

**2. No notice given**

If no notice is given by any of the successive assignees the obligor will be discharged by paying the assignor (see Article 9.1.10(1)).

**3. Notice without adequate proof**

Notice by an assignee without there being adequate proof that the assignment has been made, may be ineffective under Article 9.1.12.

**ARTICLE 9.1.12***(Adequate proof of assignment)*

**(1) If notice of the assignment is given by the assignee, the obligor may request the assignee to provide within a reasonable time adequate proof that the assignment has been made.**

**(2) Until adequate proof is provided, the obligor may withhold payment.**

**(3) Unless adequate proof is provided, notice is not effective.**

**(4) Adequate proof includes, but is not limited to, any writing emanating from the assignor and indicating that the assignment has taken place.**

**COMMENT**

Since receiving the notice of assignment has the important effects provided for in Articles 9.1.10 and 9.1.11, this Article intends to protect the obligor against the risk of receiving a fraudulent notice from a fake “assignee” by requiring adequate proof that the assignment has actually been made. Until adequate proof is provided, the obligor may withhold payment to the alleged assignee. If adequate proof is provided, notice is effective from the date it was provided.

**Illustration**

On 1 December purchaser X has to pay USD 200,000 to contractor A as an instalment of the sum due for the construction of a plant. In October A assigns the right to bank B. Either A or B may give notice of the assignment to X. If B takes the initiative and writes to X that it has become the assignee of the sum, X may require B to provide adequate proof. Without prejudice to other types of evidence, B will probably produce the assignment agreement or any other writing from A confirming that the right has been assigned. Until such adequate proof is provided, X may withhold payment.

**ARTICLE 9.1.13***(Defences and rights of set-off)*

**(1) The obligor may assert against the assignee all defences that the obligor could assert against the assignor.**

**(2) The obligor may exercise against the assignee any right of set-off available to the obligor against the assignor up to the time notice of assignment was received.**

**COMMENT****1. Assertion of defences**

A right can in principle be assigned without the obligor's consent (see Article 9.1.7(2)). This solution rests on the assumption that the assignment will not adversely affect the obligor's legal situation.

It can happen that the obligor would have been able to withhold or refuse payment to the original obligee on the basis of a defence such as the defective performance of that obligee's obligations vis-à-vis the obligor. To determine whether such defences can be asserted also against the assignee, the respective interests of the parties have to be weighed: the obligor's situation should not deteriorate as a result of the assignment, while the assignee has an interest in the integrity of the right it has acquired.

According to paragraph (1) of this Article, the obligor may assert against the assignee all the defences that it would have been able to assert if the claim had been made by the assignor. In this case, however, the assignee will have a claim against the assignor under Article 9.1.15(d).

**Illustration**

1. Software company A promises customer X to install a new accounting application before the end of the year. The main payment is to take place one month after completion. A immediately assigns the right to bank B. When the payment is due, B wants to claim it from X, but the latter explains that the new software is not working properly and that the accounting department is in chaos. X refuses to pay until this catastrophic situation has been remedied. X is justified in asserting this defence against B, which can then claim against A under Article 9.1.15(d).

The same solution applies to defences of a procedural nature.

**Illustration**

2. Company X sells a gas turbine to contractor A, to be incorporated into a plant built for customer B. When the work has been completed, A assigns the guarantee of satisfactory performance to B. When the turbine does not work properly, B sues X before a court at its place of business. X will successfully invoke the arbitration clause included in its contract with A.

**2. Set-off**

According to paragraph (2), the obligor may exercise against the assignee any right of set-off provided that the right of set-off was available to the obligor under Article 8.1 before the notice of the assignment was given.

This solution is in accord with the principle that the obligor's situation should not deteriorate as a result of the assignment. The assignee's interests are protected by the claim it may then have against the assignor under Article 9.1.15(e).

**Illustration**

3. Company A assigns to company B the right to the payment of EUR 100,000 that it has against company X. X however has a claim of EUR 60,000 against A. The two claims have not yet been set off by notice given under Article 8.3 of the Principles, but the required conditions for set-off were satisfied before the assignment was notified. X may still exercise its right of set-off by giving notice to the assignee. B can then only claim EUR 40,000 from X. B can recover the difference from A which had undertaken under Article 9.1.15(e) that the obligor would not give notice of set-off as regards the assigned right.

**ARTICLE 9.1.14**

*(Rights related to the right assigned)*

**The assignment of a right transfers to the assignee:**

- (a) all the assignor's rights to payment or other performance under the contract in respect of the right assigned, and**
- (b) all rights securing performance of the right assigned.**



**COMMENT****1. Scope of the assignment**

This provision is inspired by the same principle as Article 9.1.13. The assignment transfers the assignor's right as it is, not only with the defences the obligor may be able to assert, but also with all the rights to payment or to other performances under the contract in respect of the right assigned, and all rights securing performance of the right assigned.

**Illustrations**

1. Bank A is entitled to receive reimbursement of a loan of EUR 1,000,000 made to customer X, bearing interest at a rate of 3%. A assigns its right to reimbursement of the principal to bank B. The assignment also operates as a transfer of the right to interest and of the underlying security.
2. The initial facts are the same as in Illustration 1, but the loan contract entitles A to claim early repayment if X fails to pay the interest due. This right is also transferred to B.
3. The initial facts are the same as in Illustration 1, but X has deposited some shares as security to the benefit of A. This benefit is transferred to B, subject to the possible application of mandatory requirements of the otherwise applicable law under Article 1.4.

**2. Partial assignment**

When a right is partially assigned, if the rights covered by Article 9.1.14 are divisible they will be transferred in proportion. If they are not, parties should decide whether they are transferred to the assignee or whether they will remain with the assignor.

**3. Contractual deviations**

The rule laid down in paragraph (1) may however be modified by an agreement between the assignor and the assignee, who may stipulate, for instance, a separate assignment of interest.

**4. Assignor's co-operation**

It follows from the general duty to co-operate laid down in Article 5.1.3 that the assignor is obliged to take all the steps necessary to permit the assignee to enjoy the benefit of accessory rights and securities.

**ARTICLE 9.1.15***(Undertakings of the assignor)*

The assignor undertakes towards the assignee, except as otherwise disclosed to the assignee, that:

- (a) the assigned right exists at the time of the assignment, unless the right is a future right;
- (b) the assignor is entitled to assign the right;
- (c) the right has not been previously assigned to another assignee, and it is free from any right or claim from a third party;
- (d) the obligor does not have any defences;
- (e) neither the obligor nor the assignor has given notice of set-off concerning the assigned right and will not give any such notice;
- (f) the assignor will reimburse the assignee for any payment received from the obligor before notice of the assignment was given.

**COMMENT**

When assigning a right by agreement to the assignee, the assignor assumes several undertakings.

**1. Existence of the right**

The assigned right should exist at the time of the assignment. This would, for instance, not be the case if the payment had already been made or if the right to a payment had previously been avoided.

**Illustration**

1. Company A assigns a bundle of rights to factor B. When required to pay by B, customer X demonstrates that the amount due had been paid to A before the assignment. B has a claim against A, since at the time of the assignment the right no longer existed.

If, as permitted by Article 9.1.5, a future right is assigned, no such undertaking exists.

### Illustration

2. Company A assigns to bank B the royalties from a technology licence that is to be granted in the near future to company X. The licence never materialises. B has no claim against A.

## 2. Assignor entitled to assign the right

The assignor is entitled to assign the right. This is, for instance, not the case if there is a legal or contractual prohibition to assign the right.

### Illustration

3. Company X has agreed to communicate to company A all the improvements to a technical process that it will develop over a period of time. Their contract stipulates that A's rights towards X cannot be assigned. A no longer needs the technology itself, and attempts to assign its rights to company B. This illustration was already given above, under Article 9.1.9, to give an example of an ineffective assignment. In this case, B has a claim against A under Article 9.1.15(b). It will be recalled that the solution would be reversed, should B demonstrate that it neither knew nor ought to have known of the non-assignment clause.

## 3. No previous assignment, no third party rights or claims

If the assignor has already assigned a right to another assignee, it is generally not entitled to make a second assignment of that same right and this prohibition could be considered as already covered by the undertaking under sub-paragraph (b). The practical importance of this hypothesis is such that a separate and explicit provision is justified. It will however be recalled that under Article 9.1.11 the second assignee may prevail over the first one if it gives earlier notice to the obligee.

However, a previous assignment may have been made merely for security purposes. In this case, the right is still assignable, with proper disclosure to the second assignee.

## 4. No defence from the obligor

According to Article 9.1.13(1), the obligor may assert against the assignee all the defences that the obligor would have been able to assert against the assignor. In such a case, the assignee has a claim against the assignor on the basis of this undertaking.

**Illustration**

4. Bank B is the assignee of contractor A's right to payment of a certain sum from customer X. When payment is due, X refuses to pay arguing that A did not perform its obligations properly. Such defence can be successfully set up against B under Article 9.1.13(1). B would then have a claim against A.

**5. No notice of set-off**

The right of set-off may be exercised by the obligor against the assignee if it was available to the obligor before the notice of assignment was received (see Article 9.1.13(2)). The assignor undertakes vis-à-vis the assignee that neither the assignor nor the obligor has already given notice of set-off affecting the assigned right. The assignor also undertakes that such notice will not be given in the future. If, for instance, the obligor were to give such a notice to the assignee after the assignment, as permitted by Article 9.1.13(2), the assignee would have a claim against the assignor under Article 9.1.15(e).

**6. Reimbursement of payment by the obligor**

Article 9.1.10(1) provides that until it receives the notice of assignment the obligor is discharged by paying the assignor. This is the correct solution to protect the obligor, but the assignor and the assignee have agreed between themselves on the transfer of the right. The assignor therefore undertakes that it will reimburse the assignee for any payment it received from the obligor before the notice of assignment was given.

**Illustration**

5. Seller A assigns to bank B its right to payment from buyer X. Neither A nor B gives notice to X. When payment is due, X pays A. As already explained in the Comment on Article 9.1.10, this payment is fully valid and B is discharged. However, Article 9.1.15(f) enables B to recover the sum paid from A.

**7. No undertaking concerning the obligor's performance or solvency**

Parties to the assignment may certainly provide for an undertaking by the assignor concerning the obligor's present or future solvency, or, more generally, the obligor's performance of its obligations. However, without such an agreement, there is no such undertaking under this Article.

### Illustration

6. Company B is the assignee of company A's right to payment of a certain sum from customer X. When payment is due, B finds out that X has become insolvent. B has to bear the consequences. The solution would be the same if B discovered that X was already insolvent at the time of the assignment.

In case of breach of one of the assignor's undertakings, the remedies provided for in Chapter 7 become available. The assignee may for instance claim damages from the assignor or terminate the agreement if the conditions of Article 7.3.1 *et seq.* are fulfilled.

### 8. Effect of disclosure on undertaking

Some of the assignor's undertakings may be affected by disclosures made at the time of the transfer. The assignor may for instance advise the assignee of the existence of a claim by a third party, in which case the assignee may accept the transfer of the right at its own risk, with no undertaking on that matter on the part of the assignor.

## SECTION 2: TRANSFER OF OBLIGATIONS

### ARTICLE 9.2.1 *(Modes of transfer)*

**An obligation to pay money or render other performance may be transferred from one person (the “original obligor”) to another person (the “new obligor”) either**

**(a) by an agreement between the original obligor and the new obligor subject to Article 9.2.3, or**

**(b) by an agreement between the obligee and the new obligor, by which the new obligor assumes the obligation.**

#### COMMENT

As is the case with the assignment of rights covered by Section 1 of this Chapter, also the transfer of obligations may serve useful economic purposes. For instance, if company A can claim payment from its customer B, but itself owes a similar amount to its supplier X, it may be practical to arrange for the customer to become the supplier’s obligor.

Such a transfer of an obligation may occur in two different ways.

#### **1. Transfer by agreement between the original obligor and the new obligor**

In practice, the more frequent of the two ways indicated in this Article to transfer an obligation is by agreement between the original obligor and the new obligor, with the obligee’s consent as required by Article 9.2.3.

#### Illustration

1. Company A owes its supplier X EUR 50,000, and customer B owes the same sum to A. A and B agree that the latter will take over the former’s obligation towards X. The obligation is transferred if X agrees to the transaction.

#### **2. Transfer by agreement between the obligee and the new obligor**

Another possibility is an agreement between the obligee and the new obligor, by which the new obligor accepts to take over the obligation.

### Illustration

2. The products of company X are sold by distributor A on a certain market. The contract between the parties is close to termination. Distributor B enters into negotiations with X, proposing to take over the distributorship. In order to gain X's acceptance, B promises that it will assume a debt of EUR 50,000 still owed by A to X, and X accepts. B has become X's obligor.

### 3. Obligee's consent necessary

In both cases, the obligee must give its consent to the transfer. This is obvious when the transfer occurs by agreement between the obligee and the new obligor. If it occurs by an agreement between the original obligor and the new obligor, the requirement is stated in Article 9.2.3. Consent may be given in advance under Article 9.2.4.

Without the obligee's consent, the obligor may agree with another person that the latter will perform the obligation under Article 9.2.6.

### 4. Transfer by agreement only

Only transfers by agreement are governed by this Section, as opposed to situations where the applicable law may provide for legal transfers (such as, under certain jurisdictions, the automatic transfer of obligations in the case of the merger of companies – see Article 9.2.2).

### 5. Obligations in respect of payment of money or other performance

This Section is not restricted to the transfer of obligations in respect of payment of money. It covers also the transfer of obligations relating to other kinds of performance, such as the rendering of a service. Nor are transferable obligations limited to obligations of a contractual nature. Obligations deriving from tort law or based on a judgment, for instance, can be governed by this Section, subject to Article 1.4.

### 6. What is meant by “transfer”

The “transfer” of an obligation means that it leaves the original obligor's assets to enter those of the new obligor.

However, in some cases although the new obligor becomes bound towards the obligee, the original obligor is not discharged (see Article 9.2.5).

**ARTICLE 9.2.2***(Exclusion)*

**This Section does not apply to transfers of obligations made under the special rules governing transfers of obligations in the course of transferring a business.**

**COMMENT**

The Articles contained in this Section do not apply to transfers of obligations made in the course of transferring a business under any special rules governing such transfers, as may happen in the case of the merger of companies. The applicable law often provides for mechanisms that cause all rights and obligations to be transferred under certain conditions in their entirety by operation of law.

Article 9.2.2 does not prevent this Section from applying when certain obligations pertaining to the transferred business are transferred individually.

**Illustrations**

1. Company A is transferred to company B. If the otherwise applicable law provides that all obligations pertaining to the former company are automatically transferred to the latter, the Principles do not apply.
2. The facts are the same as in Illustration 1, but B has reasons to prefer not to become the obligor of company X, one of A's suppliers. A can transfer the obligations concerned to company C, with the consent of X. This particular transfer is subject to the Principles.

**ARTICLE 9.2.3***(Requirement of obligee's consent to transfer)*

**The transfer of an obligation by an agreement between the original obligor and the new obligor requires the consent of the obligee.**



**COMMENT****1. Agreement between the original and the new obligor**

As stated in Article 9.2.1(a), the transfer of an obligation may occur by an agreement between the original obligor and the person who will become the new obligor.

**2. Obligee's consent required**

This agreement, however, does not suffice to transfer the obligation. It is also necessary for the obligee to give its consent.

This is different from the corresponding rule on the assignment of rights, where the operation is in principle effective without the consent of the obligor (see Article 9.1.7). The assignment of a right does not affect the obligor's situation, except that the obligor will have to deliver performance to another person. On the contrary, a change of obligor may considerably affect the obligee's position, as the new obligor may be less reliable than the original one. The change may therefore not be imposed on the obligee, who must consent to it.

**Illustration**

Company A owes USD 150,000 to company X, located in Asia, for services rendered. Due to a reorganisation of the group, A's activities in Asia are taken over by affiliate company B. A and B agree that B will take over A's debt towards X. The obligation is transferred only if X gives its consent.

**3. Original obligor not necessarily discharged**

With the obligee's consent, the new obligor becomes bound by the obligation. It does not necessarily follow that the original obligor is discharged (see Article 9.2.5).

**4. Lack of consent by the obligee**

If the obligee refuses to consent to the transfer, or if its consent is not solicited, an arrangement for a third party performance is possible under Article 9.2.6.

**ARTICLE 9.2.4**

*(Advance consent of obligee)*

**(1) The obligee may give its consent in advance.**

**(2) If the obligee has given its consent in advance, the transfer of the obligation becomes effective when a notice of the transfer is given to the obligee or when the obligee acknowledges it.**

**COMMENT****1. Advance consent by the obligee**

Paragraph (1) of this Article provides that the obligee's consent, required under Article 9.2.3, may be given in advance.

**Illustration**

1. Licensor X enters into a transfer of technology agreement with licensee A. For a period of ten years, A will have to pay royalties to X. When the contract is concluded, A envisages that at some time in the future it will prefer the royalties to be paid by its affiliate, company B. X may agree in advance in the contract to the obligation to pay the royalties being transferred by A to B.

**2. When the transfer is effective as to the obligee**

According to paragraph (2), if the obligee has given its consent in advance, the transfer of the obligation becomes effective when it is notified to the obligee or when the obligee acknowledges it. This means that it is sufficient for either the original or the new obligor to notify the obligee of the transfer when it occurs. Notification is not needed if it appears that the obligee has acknowledged the transfer, to which it had given its consent in advance. "Acknowledgement" means giving an overt sign of having become aware of the transfer.

**Illustrations**

2. The facts are the same as in Illustration 1, but there comes a time when A actually agrees with B that from then on the latter will take over the obligation to pay the royalties. This decision becomes effective when notice is given to X.

3. The facts are the same as in Illustration 1. No notice is given, but the first time B pays the yearly royalties, X writes to B to acknowledge receipt of the payment and to confirm that from then on it will expect B to pay the royalties. The transfer is effective with this acknowledgement.

### ARTICLE 9.2.5

*(Discharge of original obligor)*

**(1) The obligee may discharge the original obligor.**

**(2) The obligee may also retain the original obligor as an obligor in case the new obligor does not perform properly.**

**(3) Otherwise the original obligor and the new obligor are jointly and severally liable.**

#### COMMENT

##### **1. Extent of original obligor's discharge**

The obligee's consent, whether given under Article 9.2.1(b) or under Article 9.2.3, has the effect of binding the new obligor to the obligation. What still remains to be determined is whether the original obligor is discharged. It is primarily up to the obligee to choose among different options. Only in the case of Article 9.2.1(b) will the choice depend also on the original obligor.

##### **2. Obligee's choice: full discharge**

The obligee may first of all fully discharge the original obligor.

#### Illustration

1. Supplier X accepts that its obligor company A transfer its obligation to pay the price to customer B. Fully confident that the new obligor is solvent and reliable, X discharges A. Should B fail to perform, the loss will be on X who will have no recourse against A.

**3. Obligee's choice: original obligor retained as a subsidiary obligor**

Another possibility is for the obligee to accept the transfer of the obligation from the original obligor to the new obligor on condition that it retain a claim against the original obligor.

There are two options.

The first option is that the original obligor is retained as an obligor in the event that the new obligor does not perform properly. In this case the obligee must claim performance first from the new obligor, but if the new obligor does not perform properly the obligee may call upon the original obligor.

**Illustration**

2. Supplier X accepts that its obligor company A transfer its obligation to pay the price to customer B, but this time stipulates that A will remain bound if B does not perform properly. X no longer has a direct claim against A, and must first request performance from B. However, should B fail to perform, X will have a claim against A.

**4. Obligee's choice: original obligor and new obligor jointly and severally liable**

The second option, the one most favourable to the obligee, is to consider the original obligor and the new obligor jointly and severally liable. This means that when performance is due, the obligee can exercise its claim against either the original or the new obligor (see Articles 11.1.3 *et seq.*). Should the obligee obtain performance from the original obligor, the latter would then have a claim against the new obligor (see Articles 11.1.10 *et seq.*).

**Illustration**

3. Supplier X accepts that its obligor company A transfer its obligation to pay the price to customer B, but stipulates that A and B will remain jointly and severally liable. In this case X may request performance from either A or B. Should B perform properly, both A and B would be fully discharged. Should A have to render performance to X, it would then have right of recourse against B.

## 5. Default rule

The language of this Article makes it clear that the last-mentioned option is the default rule. In other words, if the obligee has neither indicated that it intends to discharge the original obligor, nor indicated that it intends to keep the original obligor as a subsidiary obligor, the original obligor and the new obligor are jointly and severally liable.

### Illustration

4. Supplier X accepts that its obligor company A transfer its obligation to pay the price to customer B, but says nothing about the liability of A. Also in this case X may request performance from either A or B. Should B perform properly, both the original and the new obligor would be fully discharged. Should A have to render performance to X, it would then have right of recourse against B.

## 6. Original obligor refusing to be discharged

When the obligation is assumed by means of an agreement between the obligee and the new obligor, as provided in Article 9.2.1(b), and the agreement provides that the original obligor is discharged, the agreement amounts to a contract in favour of a third party. Under Article 5.2.6 such a benefit cannot be imposed on the beneficiary, who may have reasons not to accept it. The original obligor may thus refuse to be discharged by the agreement between the obligee and the new obligor.

If such a refusal occurs, the new obligor is bound to the obligee, but the original obligor and the new obligor are jointly and severally liable, in accordance with the default rule of Article 9.2.5(3).

### Illustration

5. The facts are the same as in Illustration 1, except that the obligation is assumed by an agreement between X and B, and that X discharges A. If A is no longer interested in a business relationship with B, it may accept to be discharged. On the other hand, if A wants to keep the possibilities it has of benefiting from a renewal of its contract with X, it might wish to keep the relationship and may therefore refuse to be discharged.

**ARTICLE 9.2.6***(Third party performance)*

**(1) Without the obligee's consent, the obligor may contract with another person that this person will perform the obligation in place of the obligor, unless the obligation in the circumstances has an essentially personal character.**

**(2) The obligee retains its claim against the obligor.**

**COMMENT****1. Agreement on performance by another party**

Obligations can be transferred either by an agreement between the original obligor and the new obligor, with the obligee's consent (see Article 9.2.1(a)), or by an agreement between the obligee and the new obligor (see Article 9.2.1(b)).

There may be situations in which the consent of the obligee is lacking, either because it has not been solicited, or because it has been refused. In such cases the obligor may agree with another person that this person will perform the obligation in its place. When performance becomes due, the other person will render it to the obligee.

While an obligee may refuse to accept a new obligor before performance is due, in principle it may not refuse to accept the performance itself when it is offered by another party.

**Illustration**

1. Companies A and B have entered into a co-operation agreement for their activities on a certain market. At a certain point they decide to redistribute some of their tasks. Thus, B will take over all operations concerning telecommunications which were previously A's responsibility. On the following 30 October A would have been bound to pay company X, a local operator, a sum of USD 100,000. The two partners agree that B will pay that amount when it is due. On 30 October X may not refuse such a payment made by B.

**2. Obligation of an essentially personal character**

Third party performances may not be refused by the obligee in all the cases in which they would be equally satisfactory as performances rendered by the obligor. The situation is different when the performance due is of an essentially personal character, linked to the

obligor's specific qualifications. The obligee may then insist on receiving performance by the obligor itself.

### Illustration

2. In Illustration 1, B also takes over operations for the maintenance of some sophisticated technological equipment developed by A and sold to company Y. The partners agree that the next yearly maintenance will be carried out by B. When B's technicians arrive at Y's premises, Y may refuse their intervention, invoking the fact that due to the highly technical nature of the verifications involved, they are entitled to receive performance from the specialised staff of A.

### ARTICLE 9.2.7

*(Defences and rights of set-off)*

**(1) The new obligor may assert against the obligee all defences which the original obligor could assert against the obligee.**

**(2) The new obligor may not exercise against the obligee any right of set-off available to the original obligor against the obligee.**

### COMMENT

#### 1. Assertion of defences

The obligation transferred to the new obligor is the very same obligation that used to bind the original obligor (and, in some cases, still binds it - see Article 9.2.5).

Whenever the original obligor would have been able to withhold or refuse payment to the obligee on the basis of a defence, such as the defective performance of the obligee's own obligations, the new obligor may rely on the same defence against the obligee.

### Illustration

1. Company A owes company X EUR 200,000, due to be paid at the end of the year, as payment for facilities management services. With X's consent A transfers this obligation to company B. X renders A extremely defective services which would have given A a valid defence for refusing payment. When payment is due, B may assert the same defence against X.

**2. Defences of a procedural nature**

The same solution applies to defences of a procedural nature.

**Illustration**

2. The facts are the same as in Illustration 1, except that X sues B before a court at its place of business. B can successfully invoke the arbitration clause included in the contract between A and X.

**3. Set-off**

The right of set-off relating to an obligation owed by the obligee to the original obligor may however not be exercised by the new obligor. The reciprocity requirement is not fulfilled between the obligee and the new obligor. The original obligor may still exercise its right of set-off if it has not been discharged.

**ARTICLE 9.2.8**

*(Rights related to the obligation transferred)*

**(1) The obligee may assert against the new obligor all its rights to payment or other performance under the contract in respect of the obligation transferred.**

**(2) If the original obligor is discharged under Article 9.2.5(1), a security granted by any person other than the new obligor for the performance of the obligation is discharged, unless that other person agrees that it should continue to be available to the obligee.**

**(3) Discharge of the original obligor also extends to any security of the original obligor given to the obligee for the performance of the obligation, unless the security is over an asset which is transferred as part of a transaction between the original obligor and the new obligor.**



**COMMENT****1. Scope of the transfer**

The rules laid down in this Article are inspired by the same principle as Article 9.2.7. The obligation is transferred to the new obligor as it is, not only with the defences the original obligor was able to assert, but also with all the rights to payment or to other performances under the contract that the obligee had in respect of the obligation transferred.

The following illustrations provide examples of such rights.

**Illustrations**

1. Company A must reimburse bank X for a loan of EUR 1,000,000 bearing an interest rate of 3%. A transfers its obligation to reimburse the principal to company B. The transfer also includes the obligation to pay the 3% interest.
2. The facts are the same as in Illustration 1, except that the loan contract entitles X to claim premature reimbursement if A fails to pay the interest due. X can assert also this right against B.

**2. Contractual deviations**

Party autonomy permits deviations from the rules laid down in this Article, such as a separate transfer of the obligation to pay interest.

**3. Securities in assignment of rights and transfer of obligations compared**

In the case of the assignment of a right, all rights securing performance are automatically transferred to the assignee (see Article 9.1.14(b)). This solution is justified by the fact that the assignment of a right does not alter the obligor's situation, i.e. securities can continue to serve their purposes in unchanged circumstances.

The transfer of an obligation to a new obligor on the contrary modifies the context in which the security has been granted. If the original obligor is discharged, and if the security were to be transferred with the obligation, the risk of breach or insolvency to be covered would be that of another person, thus completely altering the object of the security.

**4. Suretyship**

If the original obligor's obligation was covered by a suretyship granted by another person, this suretyship can survive if the original obligor remains bound. If, on the other hand, the original obligor is discharged, the suretyship cannot be transferred to cover the new obligor, unless the person who granted the suretyship agrees that it should continue to be available to the obligee.

**Illustration**

3. Company A owes USD 1,000,000 to company X. Bank S has agreed to guarantee due performance of this obligation. With X's agreement, A transfers the obligation to company B, and X accepts to discharge A. S does not guarantee B's obligation, unless it agrees to continue to provide the security.

A special case occurs when the suretyship was granted by the person who was itself to become the new obligor. In such a case, the security necessarily disappears, since a person cannot provide a security for its own obligation.

**5. Securities over assets**

The original obligor may have given one of its assets as security. In this case, if the obligation is transferred and the original obligor is discharged, the security ceases to cover the obligation now binding the new obligor.

**Illustration**

4. Bank X has granted a loan of EUR 100,000 to company A, secured by a deposit of shares by the obligor. With X's agreement, A transfers the obligation to pay back the loan to company B, and X accepts to discharge A. The shares cease to serve as security.

The solution is different if the asset given as security is transferred as part of a transaction between the original and the new obligor.

**Illustration**

5. The facts are the same as in Illustration 4, but the transfer of the obligation between A and B occurs as part of a broader operation in which ownership of the shares is also transferred to B. In such a situation, the shares will continue to serve as security for B's obligation to reimburse the loan.

## SECTION 3: ASSIGNMENT OF CONTRACTS

### ARTICLE 9.3.1

#### *(Definitions)*

**“Assignment of a contract” means the transfer by agreement from one person (the “assignor”) to another person (the “assignee”) of the assignor’s rights and obligations arising out of a contract with another person (the “other party”).**

#### COMMENT

Rights and obligations can be transferred separately, under the respective rules of Sections 1 and 2 of this Chapter. In some cases, however, a contract is assigned as a whole. More precisely, a person transfers to another person all the rights and obligations deriving from its being a party to a contract. A contractor, for instance, may wish to let another contractor replace it as one of the parties in a construction contract. The Articles of this Section cover the assignment of contracts as defined in this Article.

Only transfers by agreement are concerned, as opposed to various situations where the applicable law may provide for legal transfers (such as, under certain jurisdictions, the automatic transfer of contracts in the case of the merger of companies - see Article 9.3.2).

### ARTICLE 9.3.2

#### *(Exclusion)*

**This Section does not apply to the assignment of contracts made under the special rules governing transfers of contracts in the course of transferring a business.**

#### COMMENT

The assignment of contracts may be subject to special rules of the applicable law when it is made in the course of the transfer of a

business. Such special rules often provide for mechanisms that cause all contracts of the business to be transferred, under certain conditions, by operation of law.

This Article does not prevent the present Section from applying when certain contracts pertaining to the transferred business are assigned individually.

#### **Illustrations**

1. Company A is transferred to company B. If the otherwise applicable law provides that all contracts to which the former company was a party are automatically transferred to the latter, the Principles do not apply.
2. The facts are the same as in Illustration 1, but B is not interested in taking over a particular contract with company X, and prefers that contract to be assigned to company C. This particular transfer is subject to the Principles.

### **ARTICLE 9.3.3**

*(Requirement of consent of the other party)*

**The assignment of a contract requires the consent of the other party.**

#### **COMMENT**

##### **1. Agreement between assignor and assignee**

The first requirement for the assignment of a contract is that the assignor and the assignee agree on the operation.

##### **2. Other party's consent required**

This agreement does not however suffice to transfer the contract. It is also necessary for the other party to give its consent.

If it were only for the assignment of the rights involved, such a consent would in principle not be needed (see Article 9.1.7). However, the assignment of a contract also involves a transfer of obligations, which cannot be effective without the obligee's consent (see Article 9.2.3). The assignment of a contract can thus only occur with the other party's consent.

### Illustration

Office space is let by owner X to company A. The contract expires only six years from the date of the contract. Due to the development of its business, A wants to move to larger premises. Company B would be interested in taking over the lease. The contract can be assigned by an agreement between A and B, but the operation also requires X's consent.

### 3. Assignor not necessarily discharged of its obligations

With the other party's consent, the assignee becomes bound by the assignor's obligations under the assigned contract. It does not necessarily follow that the assignor is discharged (see Article 9.3.5).

#### ARTICLE 9.3.4

*(Advance consent of the other party)*

**(1) The other party may give its consent in advance.**

**(2) If the other party has given its consent in advance, the assignment of the contract becomes effective when a notice of the assignment is given to the other party or when the other party acknowledges it.**

### COMMENT

#### 1. Advance consent by the other party

Paragraph (1) of this Article provides that the other party's consent, required under Article 9.3.3, may be given in advance.

This rule, concerning the assignment of contracts, corresponds to the rule in Article 9.2.4 according to which the obligee, who must consent to the transfer of the obligation may give its consent in advance. Similarly, the other party, who must consent to the assignment of the contract, may also give its consent in advance.

### Illustration

1. Company X enters into an agreement with agency A, providing that the latter will be responsible for advertising X's products in country M for the next five years. A, however, is

already considering ceasing its activities in country M in the not too distant future, and obtains X's advance consent to the subsequent assignment of the contract to agency B, located in country M's capital. This advance consent is effective under Article 9.3.4.

## **2. When the assignment of the contract is effective vis-à-vis the other party**

According to paragraph (2), if the other party has given its consent in advance, the assignment of the contract becomes effective when it is notified to the other party or when the other party acknowledges it. This means that it is sufficient for either the assignor or the assignee to notify the assignment when it occurs. Notification is not needed if it appears that the obligee has acknowledged the transfer, to which it had given its consent in advance. "Acknowledgement" means giving an overt sign of having become aware of the transfer.

### **Illustrations**

2. The facts are the same as in Illustration 1. When A actually assigns its contract to B, the assignment becomes effective vis-à-vis the other party when either A or B notifies it to X.
3. The facts are the same as in Illustration 1. No notice is given, but B sends X a proposal for a new advertising campaign. X understands that the assignment has taken place and sends its comments on the proposal to B. The assignment of the contract is effective with this acknowledgement.

### **ARTICLE 9.3.5**

#### *(Discharge of the assignor)*

- (1) The other party may discharge the assignor.**
- (2) The other party may also retain the assignor as an obligor in case the assignee does not perform properly.**
- (3) Otherwise the assignor and the assignee are jointly and severally liable.**

**COMMENT****1. Extent of assignor's discharge**

This Article, concerning the assignment of contracts, corresponds to Article 9.2.5. To the extent that the assignment of a contract causes obligations to be transferred from the assignor to the assignee, the other party, as an obligee, may decide the effect that the acceptance of the assignee as a new obligor will have on the assignor's obligations. This Article gives the other party several choices and provides for a default rule.

**2. Other party's choice: full discharge**

The other party may first of all fully discharge the assignor.

**Illustration**

1. By contract with company X, company A has undertaken to dispose of the waste produced by an industrial process. At a certain point, X accepts that the contract is assigned by A to company B. Fully confident that B is solvent and reliable, X discharges A. Should B fail to perform properly, X will have no recourse against A.

**3. Other party's choice: assignor retained as a subsidiary obligor**

Another possibility is for the other party to accept the assignment of the contract on condition that it retain a claim against the assignor.

There are two options.

The first option is that the assignor is retained as an obligor in the event that the assignee does not perform properly. In this case the other party must necessarily claim performance first from the assignee, but if the assignee does not perform properly, the other party may call upon the assignor.

**Illustration**

2. The facts are the same as in Illustration 1, except that X, when consenting to the assignment, has stipulated that A will remain bound if B does not perform properly. X no longer has a direct claim against A, and must first request performance from B. However, should B fail to perform, then X would have a claim against A.

**4. Other party's choice: assignor retained as jointly and severally liable with the assignee**

The second option, the one most favourable to the other party, is to consider the assignor and the assignee jointly and severally liable. This means that when performance is due, the other party can exercise its claim against either the assignor or the assignee (see Articles 11.1.3 *et seq.*). Should the other party obtain performance from the assignor, the latter would then have a claim against the assignee (see Articles 11.1.10 *et seq.*).

**Illustration**

3. Company X accepts that company A assign the contract to company B, but stipulates that A and B will remain jointly and severally liable. In this case X may require performance from either A or B. Should B perform properly, both A and B would be fully discharged. Should A have to render performance to X, it would then have a right of recourse against B.

**5. Default rule**

The language of this Article makes it clear that the last-mentioned option is the default rule. In other words, if the other party has neither indicated that it intends to discharge the assignor, nor indicated that it intends to keep the assignor as a subsidiary obligor, the assignor and the assignee are jointly and severally liable.

**Illustration**

4. Company X accepts that company A assign the contract to company B, but says nothing about the liability of A. Also in this case X may request performance from either A or B. Should B perform properly, both A and B would be fully discharged. Should A have to render performance to X, it would then have a right of recourse against B.

**6. Differentiated options possible**

A party to a contract is often subject to a whole set of obligations. When the contract is assigned, the other party may choose to exercise different options with regard to the different obligations. The other party may for instance accept to discharge the assignor for a certain obligation, but to retain it either as a subsidiary obligor or to consider it jointly and severally liable with the assignee with respect to other obligations.



### Illustration

5. Company A has entered into a know-how licence contract with company X. In return for the transferred technology, A has undertaken to pay royalties and to co-operate with X in the development of a new product. When X later on accepts that A assign the contract to company B, X discharges A from the obligation to participate in the joint research, for which it will deal with the assignee only, but retains A as a subsidiary or a jointly and severally liable with B for the payment of royalties.

### ARTICLE 9.3.6

*(Defences and rights of set-off)*

**(1) To the extent that the assignment of a contract involves an assignment of rights, Article 9.1.13 applies accordingly.**

**(2) To the extent that the assignment of a contract involves a transfer of obligations, Article 9.2.7 applies accordingly.**

### COMMENT

The assignment of a contract entails both an assignment of the original rights and a transfer of the original obligations from the assignor to the assignee. The transaction should not adversely affect the other party's situation as an obligor and it should put the assignee in the same situation as the assignor in its capacity as obligor.

As a consequence, the provisions concerning defences in Sections 1 and 2 of this Chapter apply accordingly. When the assignee exercises its rights, the other party may assert all the defences it could have asserted as obligor if the claim had been made by the assignor (see Article 9.1.13). When the other party exercises its rights, the assignee may assert all the defences that the assignor could have asserted as obligor if the claim had been made against it (see Article 9.2.7).

### Illustrations

1. Company X has out-sourced its risk management department to consultant A. With X's consent, the contract is assigned to consultant B. Due to A's incompetence, X was not properly insured for a loss it subsequently suffered. Pending indemnification, X may suspend paying B the agreed fees.

2. Airline A has a contract with catering company X. A transfers the operation of its flights to certain destinations to airline B. With X's consent, the catering contract is assigned by A to B. Litigation later arises, and X sues B before a court at its place of business. As a procedural defence B may successfully invoke that the assigned contract includes an arbitration clause.

**ARTICLE 9.3.7**

*(Rights transferred with the contract)*

**(1) To the extent that the assignment of a contract involves an assignment of rights, Article 9.1.14 applies accordingly.**

**(2) To the extent that the assignment of a contract involves a transfer of obligations, Article 9.2.8 applies accordingly.**

**COMMENT**

The assignment of a contract entails both an assignment of the original rights and a transfer of the original obligations from the assignor to the assignee. In parallel to what has been said about defences under Article 9.3.6, the operation should not adversely affect the other party's situation as an obligee and it should place the assignee in the same situation as the assignor in its capacity as obligee.

As a consequence, the provisions of Sections 1 and 2 of this Chapter concerning rights related to the claim assigned and to the obligation transferred will apply accordingly.

When the assignee acts against the other party, it may assert all the rights to payment or other performances under the contract assigned with respect to the rights assigned, as well as all rights securing such performance (see Article 9.1.14). When the other party exercises its rights, it may assert all its rights to payment or other performances under the contract with respect to the obligation transferred against the assignee (see Article 9.2.8(1)). Securities granted for the performance of the assignor's obligations are maintained or discharged in accordance with Article 9.2.8(2) and (3).

### Illustrations

1. A service contract provides that late payment of the yearly fees due by customer X to supplier A will bear interest at the rate of 10%. With X's consent, A assigns the contract to supplier B. When X fails to pay the yearly fees on time, B is entitled to claim such interest (see Article 9.1.14(a)).
2. The facts are the same as in Illustration 1, but X has also provided A with a bank guarantee covering payment of the fees. B may call upon that guarantee should X fail to pay the fees (see Article 9.1.14(b)).
3. Company X has ordered the construction and installation of industrial equipment from company A. Performance levels have been agreed between the parties, and the contract provides for liquidated damages should actual performance be insufficient. With X's consent, A assigns the contract to company B. The assignee delivers equipment that does not meet the required performance levels. X may avail itself of the liquidated damages against B (see Article 9.2.8(1)).
4. The facts are the same as in Illustration 3, but A has provided X with a bank guarantee covering satisfactory performance. The bank guarantee will not apply to B's obligations resulting from the assignment, unless the bank accepts to continue to offer its guarantee in respect of the assignee's obligations (see Article 9.2.8(2)).

## CHAPTER 10

### LIMITATION PERIODS

#### ARTICLE 10.1

*(Scope of the Chapter)*

(1) The exercise of rights governed by the Principles is barred by the expiration of a period of time, referred to as “limitation period”, according to the rules of this Chapter.

(2) This Chapter does not govern the time within which one party is required under the Principles, as a condition for the acquisition or exercise of its right, to give notice to the other party or to perform any act other than the institution of legal proceedings.

#### COMMENT

##### 1. Notion of limitation period

All legal systems recognise the influence of passage of time on rights. There are two basic systems. Under one system, the passage of time extinguishes rights and actions. Under the other system, the passage of time operates only as a defence against an action in court. Under the Principles a lapse of time does not extinguish rights, but operates only as a defence (see Article 10.9).

This Article refers in general to “rights governed by the Principles” to indicate that not only the right to require performance or the right to another remedy for non-performance can be barred, but also the exercise of rights which directly affect a contract, such as the right of termination or a right of price reduction contractually agreed upon.

### Illustrations

1. A sells a tanker to B. Upon delivery the ship turns out not to be in conformity with the specifications contained in the contract, but it is only three and a half years later that B brings an action against A for the cure of the defects. A may raise the defence of B's claim being time-barred under Article 10.2.
2. The facts are the same as in Illustration 1, except that the contract between A and B contains a clause allowing B a price reduction of up to 30% in case of missing equipment or spare parts. B's right to a price reduction is also barred.

## 2. Notice requirements and other prerequisites for enforcing rights

Under the Principles rights can be lost if the party entitled to acquire or exercise a right fails to give notice or to perform an act within a reasonable period of time, without undue delay, or within another fixed period of time (see Articles 2.1.1 – 2.1.22 (communications in the context of formation of contracts), Article 3.15 (avoidance of contract for defects of intent), Article 6.2.3 (request for re-negotiation), Article 7.2.2(e) (request for performance), Article 7.3.2(2) (termination of the contract for non-performance)). Although they serve a function similar to limitation periods, these special time-limits and their effects are not affected by the limitation periods provided for in this Chapter as they are designed to meet special needs. As they are generally much shorter than the limitation periods provided for in this Chapter, they take effect regardless of the latter. In the exceptional case that in the circumstances a “reasonable period of time” is longer than the applicable limitation period, the former will prevail.

### Illustration

3. The facts are the same as in Illustration 1, except that B sets A an additional period of time of 60 days for the cure of the defects. A fails to cure the defects, but it is only two months after the expiry of the additional period fixed that B sends A a notice of termination under Article 7.3.2. Although B's claim is not time-barred under Article 10.2, it has lost the right to terminate the contract because it has not given notice of termination within a reasonable time as required by Article 7.3.2(2).

**3. Mandatory rules of domestic law**

In cases in which the parties' reference to the Principles is considered to be only an agreement to incorporate them in the contract, mandatory rules on limitation periods of national, international or supranational origin relating to the length, suspension, and renewal of the limitation periods as well as to the right of the parties to modify them, prevail over the rules laid down in this Chapter (see Comment 2 on Article 1.4). Yet even in cases in which the Principles are applied as the law governing the contract, domestic mandatory rules on limitation periods prevail over the rules laid down in this chapter, provided that they claim application whatever the law governing the contract (see Comment 3 on Article 1.4).

**Illustration**

4. Seller A in country X sells and delivers component parts to car manufacturer B in country Y. Some of the parts are defective and the same year of delivery the defects cause accidents for which B has to pay damages. Four years later, B asks A to be indemnified for its costs. A refuses to pay. The contract provides for arbitration in country Z with the UNIDROIT Principles as the applicable law. In an arbitration commenced by B, A raises the defence of the expiration of the three-year limitation period provided for in Article 10.2. B responds that under the law of country X the claim for damages for defective goods is time-barred only after 5 years, and that this rule claims to apply irrespective of the law governing the contract. The rule of the law of country X prevails.

**ARTICLE 10.2**

*(Limitation periods)*

**(1) The general limitation period is three years beginning on the day after the day the obligee knows or ought to know the facts as a result of which the obligee's right can be exercised.**

**(2) In any event, the maximum limitation period is ten years beginning on the day after the day the right can be exercised.**

**COMMENT****1. No common solution**

Although periods of limitation of rights and claims are common to all legal systems, they differ in length. They range from six months or one year for claims for breach of warranties, to up to 15, 20 or even 30 years for other claims. At international level the *1974 United Nations Convention on the Limitation Period in the International Sale of Goods* (as amended in 1980) (“UN Limitation Convention”) provides uniform rules but is restricted to the international sale of goods.

**2. Relevant factors**

The stated length of a limitation period does not always in itself determine the time after which the exercise of rights is barred. That time may be affected by the prerequisites for the starting of the period and by circumstances affecting its running (see Articles 10.4 to 10.9). It may also be affected by the agreement of the parties (see Article 10.3). Party autonomy with regard to limitation periods is of great practical importance, as periods that are either too long or too short may be tolerable if the parties may modify them freely according to their needs.

**3. Balance between interests of obligee and obligor**

The Principles strike a balance between the conflicting interests of the obligee and the obligor of a dormant claim. An obligee should have a reasonable chance to pursue its right, and should therefore not be prevented from pursuing its right by the lapse of time before the right becomes due and can be enforced. Furthermore, the obligee should know or at least have a chance to know its right and the identity of the obligor. On the other hand, the obligee should be able to close its files after some time regardless of the obligor’s knowledge, and consequently a maximum period should be established. Contrary to the UN Limitation Convention which has only one absolute limitation period of four years which begins on the date of accrual of the claim (see Articles 8 and 9(1)), the Principles provide for a two-tier system.

**4. Basic structure of the limitation regime**

The two-tier system adopts the policy that the obligee should not be barred before it has had a real possibility to pursue its right as a result of having actual or constructive knowledge of the right. Paragraph (1) therefore provides for a rather short three-year limitation period starting the day after the obligee knows or ought to know the facts on which its

right is based and this right can be exercised. Paragraph (2) provides for a ten-year maximum limitation period, commencing at the time when the right can be exercised, regardless of the obligee's actual or constructive knowledge.

### **5. Right can be exercised**

The obligee has a real possibility to exercise its right only if it has become due and can be enforced. Paragraph (2) therefore provides that the maximum limitation period starts only at such date.

### **6. Knowledge of the facts as distinguished from knowledge of the law**

The general three-year limitation period starts the day after the day "the obligee knows or ought to know the facts as a result of which the obligee's right can be exercised". "Facts" within the meaning of this provision are the facts on which the right is based, such as the formation of a contract, the delivery of goods, the undertaking of services, and non-performance. The facts indicating that a right or claim has fallen due must be known or at least knowable by the obligee before the general limitation period starts. The identity of the obligor may also be in doubt, e.g. in cases of agency, the transfer of debts or entire contracts, the winding-up of companies, or unclear third-party beneficiary contracts. In these cases, the obligee must know or have reason to know whom to sue before it can be blamed for not having pursued the right or claim. Actual or constructive knowledge of "facts", however, does not mean that the obligee must know the legal implications of the facts. If, despite full knowledge of the facts, the obligee is mistaken about its rights, the three-year limitation period may nevertheless start to run.

### **Illustrations**

1. A designs and builds a bridge under a contract with county B. A's engineers make a mistake in calculating the strength of some steel girders. Four years later, the bridge collapses due to a combination of the weight of some heavy trucks and a storm. B's claims for damages are not barred, because the general limitation period started only at the time of the collapse, when B was in a position to discover A's breach.
2. The facts are the same as in Illustration 1, except that the bridge collapses eleven years after its construction. B's claims are barred under the maximum limitation period under Article 10.2(2). Parties to such a contract are well advised to adjust the maximum period while remaining within the limits of Article 10.3.



3. A sends B a notice under Article 7.3.2 terminating a sales contract between A and B because B refuses to take delivery of goods tendered by A. Thirty-seven months after receipt of the note of termination, B demands the return of an advance on the purchase price paid prior to the termination, asserting that, due to an error in its bookkeeping, it had overlooked its payment of the advance with the consequence that it had only recently become aware of the claim for restitution it had under Article 7.3.6(1). B's claim for restitution is barred by the three-year limitation period, as B ought to have known of its payment when the contract was terminated and the claim to repay the advance arose.

4. The facts are the same as in Illustration 1, except that B asserts that it had not realised the legal effects of a notice of termination. B's claim for restitution is nevertheless barred. An error of law with regard to the legal effects of a notice of termination cannot absolve the obligee since "ought to know" includes seeking legal advice if the party is uncertain about the legal effects of the circumstances.

## **7. Day of commencement**

Since, in the absence of an agreement to the contrary, the obligor can normally perform its obligation in the course of the whole day of the debt's maturity, the limitation period does not start on that same day but only on the following day.

### **Illustration**

5. A is obliged to pay a sum of money on 24 November. If A does not pay by that date, the limitation period starts on 25 November.

## **8. Right must be exercisable**

An obligation may exist even if performance cannot as yet be required (see, e.g., Article 6.1.1(a)). While a creditor's claim to the repayment of a loan is founded on the contract and may therefore arise at the time of the conclusion of the contract or of the payment of the loan to the debtor, the repayment claim will usually fall due much later. Furthermore, a right may not be enforceable if the obligor has a defence.

### **Illustrations**

6. A loan agreement obliges the borrower to repay the loan on 15 November. The lender grants the borrower an extension of the date of repayment until 15 December. The limitation period starts on 16 December.

7. A contracts to build a fertiliser plant for B. The price is to be paid in three instalments, the last instalment being due four weeks after completion of the work as certified by an engineering firm. After certification there are still malfunctionings of the plant. B is entitled to withhold performance of the last instalment under Articles 7.1.3(2) and 7.1.4(4). The limitation period for the claim for payment does not begin until the right to withhold payment is extinguished by cure of the malfunctionings.

## **9. Maximum period**

Under paragraph (2) the obligee is in any event, i.e. irrespective of whether it knew or ought to have known the facts giving rise to its right, prevented from exercising the right ten years after it could have exercised it. The objectives of this maximum period of ten years are the restoration of peace and the prevention of speculative litigation where evidence has faded.

### **Illustration**

8. B borrows money from A and orders its accountant to repay the loan when repayment falls due in January. Fifteen years later, a dispute arises over whether the loan was repaid fully or only in part as A claims. A's asserted claim is barred by Article 10.2(2), because the maximum limitation period has expired.

## **10. Ancillary claims**

This Article applies to all rights, including so-called "ancillary claims".

### **Illustrations**

9. In a loan agreement, the borrower agrees to pay an interest of 0.7% per month if there is default in repayment. Thirty-five months after repayment is due, the borrower repays the principal. The lender need not sue for all successive monthly instalments of interest at once, but can wait up to thirty-six months for each instalment before it is barred.

10. Under the contract of builder A with owner B, A agrees to complete construction by 1 October and to pay EUR 50,000 for every month of delay up to a maximum amount of EUR 2,500,000. Completion is delayed for 40 months. Claims for damages for non-performance or delay are barred 36 months after 2 October. The claim for the penalty for each month of delay is barred 36 months after it arises.

**11. “Year”**

This Article does not provide a definition of “year”, because at international level a reference to “year” is usually understood as being a reference to the Gregorian calendar (see Article 1(3)(h) of the UN Limitation Convention). In any event, calendars deviating from the Gregorian calendar will in most cases have the same number of days per year, with the consequence that they do not influence the length of limitation periods. A different meaning of “year” can be agreed upon by the parties under Article 1.5. Such an agreement may be explicit or derived from an interpretation of the contract.

**ARTICLE 10.3**

*(Modification of limitation periods by the parties)*

- (1) The parties may modify the limitation periods.**
- (2) However they may not**
  - (a) shorten the general limitation period to less than one year;**
  - (b) shorten the maximum limitation period to less than four years;**
  - (c) extend the maximum limitation period to more than fifteen years.**

**COMMENT****1. Basic decision: modifications possible**

In some legal systems the power of the parties to modify limitation periods and their effects is restricted out of concern for the weaker parties and, in particular, consumers. A distinction is sometimes made between very short limitation periods, which can be prolonged, and other limitation periods, which cannot be modified or can only be shortened. Since the Principles apply to international contracts between businesspersons who are normally experienced and knowledgeable persons who do not need to be protected, they permit the parties to adapt the limitation periods applicable to the rights arising out of their contracts to their needs in a given case. Restrictions to the parties’ autonomy in this respect may, however, follow from the mandatory rules of the otherwise applicable law (see Article 1.4).

**2. Limits of modifications**

The possibility nevertheless remains that a party with superior bargaining power or better information may take advantage of the other party by either unduly shortening or lengthening the limitation period. This Article therefore limits the power to shorten the general limitation period by stating that it may not be shortened to less than one year starting from the moment of actual or constructive knowledge, and to shorten the maximum period by stating that it may not be shortened to less than four years. The maximum limitation period and, necessarily, the general period cannot exceed fifteen years.

**Illustrations**

1. The facts are the same as in Illustration 2 to Article 10.2, except that in their contract the parties provide that the maximum limitation period for all claims based on hidden defects is fifteen years. B's claim for damages is not yet barred.
2. The facts are the same as in Illustration 2 to Article 10.2, except that in their contract the parties provide that the maximum limitation period for all claims based on hidden defects is twenty-five years and the bridge collapsed after sixteen years. B's claim for damages is barred, because the maximum limitation period can be extended to only fifteen years.
3. The facts are the same as in Illustration 2 to Article 10.2, except that in their contract the parties provide that the general limitation period in case of harm resulting from the non-conformity of the bridge starts only upon the submission of a written report of experts of an independent engineering firm. After the collapse of the bridge, it is uncertain what the causes were, and it takes two years for the engineering firm to submit its report. The general limitation period begins to run only from the day after the day on which the report was submitted.

**3. Time of modification**

A modification can be agreed upon before or after the commencement of a limitation period. A modification agreed upon before or after the commencement of a limitation period differs from an agreement concluded after the limitation period has expired. Such an agreement, although too late to modify the applicable limitation period, may have legal consequences either as a waiver of the defence that the limitation period has expired or as a new promise by the obligor.

**ARTICLE 10.4**

*(New limitation period by acknowledgement)*

**(1) Where the obligor before the expiration of the general limitation period acknowledges the right of the obligee, a new general limitation period begins on the day after the day of the acknowledgement.**

**(2) The maximum limitation period does not begin to run again, but may be exceeded by the beginning of a new general limitation period under Article 10.2(1).**

**COMMENT****1. Acknowledgement of rights**

Most legal systems permit the running of the limitation period to be altered by acts of the parties or other circumstances. Sometimes acts of the parties or other circumstances “interrupt” the running of the limitation period, with the effect that a new limitation period starts. Sometimes acts or other circumstances cause a “suspension” of the running of the limitation period, with the effect that the period of suspension is not counted in computing the limitation period. According to this Article the acknowledgement of a right by the obligor causes an interruption of the limitation period (see also Article 20 of the UN Limitation Convention,).

**2. Commencement of a new general limitation period**

The new limitation period that starts following acknowledgement of the right of the obligee is the general limitation period, because by virtue of such an acknowledgement the obligee will necessarily possess the knowledge required for commencement of the limitation period under Article 10.2(1). There is therefore no need to protect the obligee by granting it a new maximum limitation period.

**Illustration**

1. A defectively performs a construction contract with B and B informs A of the non-conformities in October without receiving any response from A. Two years later B again approaches A, threatening to bring an action for damages. This time A responds and acknowledges the non-conformity of its performance and promises to cure the non-conformity. On the following day a new general limitation period starts to run for B's right to damages.

The commencement of a new general limitation period following acknowledgement can take place either during the general limitation period under Article 10.2(1), or during the maximum limitation period under Article 10.2(2). While the maximum limitation period will not in itself begin again, the new general limitation period may exceed the maximum period by up to three years if the obligor acknowledges the right of the obligee after more than seven years but before the maximum period has already expired.

**Illustration**

2. B discovers defects in the construction work of A only nine years after completion of the work. The defects could not have been discovered earlier. B threatens to initiate legal action, and A acknowledges the defects. A new general limitation period begins to run on acknowledgement, so that altogether the limitation period amounts to twelve years.

**3. Novation and other acts creating a new obligation**

Acknowledgement does not create a new obligation, it merely interrupts the running of the limitation period. Accessory rights are therefore not extinguished. Consequently, if the limitation period has already ended, a mere acknowledgement under this Article does not retroactively remove or invalidate the limitation defence.

**Illustration**

3. The facts are the same as in Illustration 2, except that B knows or ought to know of A's defective construction at the time of completion. B approaches A only 7 years later, and A acknowledges the defective performance. B's claim is nevertheless already barred under Article 10.2(1) and is not revived by A's acknowledgement.

If the parties want to undo the effects of a completed limitation period, they can create a new obligation by a “novation” or an unilateral act on the part of the obligor, or the obligor can waive the defence of the expiration of a limitation period. The parties can also prolong the duration of the obligee’s right beyond the end of the maximum limitation period under Article 10.2(2).

#### Illustrations

4. The facts are the same as in Illustration 3, except that A, in order to maintain a profitable business relation, not only acknowledges the defective performance, but promises to cure the defects regardless of any question of A’s liability. This agreement creates a new obligation for A, which is barred only three years later.

5. Nine years after completion B discovers defects in A’s construction work which could not have been discovered earlier. On notice to A, A responds that it will investigate the causes of the defects and will therefore not invoke the limitation period until six months after the experts investigating the defects submit their report. The report is submitted twelve months later, confirming B’s notice of defects. When B asks A to cure the defects, A argues that the maximum period of Article 10.2(2) has expired with the consequence that no claim for damages can be made by B. A’s argument is incorrect if B abstained from initiating judicial proceedings on account of A’s waiver.

#### 4. Interruption of limitation periods modified by the parties

To the extent that the parties have modified the general limitation period under Article 10.2(1), acknowledgement and the commencement of a new limitation period affect the general period as modified. If, for example, the parties have shortened the general limitation period to one year, acknowledgement causes a new one-year period to run.

#### Illustration

6. A and B have agreed to shorten the limitation period for claims arising from the non-conformity of A’s performance to two years. After nine and a half years B discovers defects in A’s performance, and A acknowledges its obligation to cure. B has another two years to pursue its claim before it is barred under Article 10.2(1).

Since the obligor can acknowledge more than once, the limited effect of an acknowledgement that causes only the general limitation period to start again can be overcome by a subsequent acknowledgement.

#### **Illustration**

7. A delivers non-conforming goods to B in November. B suffers loss resulting from the non-conformity because its customers complain and return the goods. Since two years later the total amount of loss is not yet clear, B pressures A to acknowledge its liability and in December of that year A complies with B's request. Two years later, there are still uncertainties regarding the exact extent of B's obligations towards its customers, some of whom have sued for compensation for consequential damages allegedly caused by the goods. B therefore turns to A again, who acknowledges its obligation to compensate B should the claims of B's customers be well-founded. B has three more years before its claims against A are barred.

### **ARTICLE 10.5**

*(Suspension by judicial proceedings)*

**(1) The running of the limitation period is suspended**

**(a) when the obligee performs any act, by commencing judicial proceedings or in judicial proceedings already instituted, that is recognised by the law of the court as asserting the obligee's right against the obligor;**

**(b) in the case of the obligor's insolvency when the obligee has asserted its rights in the insolvency proceedings; or**

**(c) in the case of proceedings for dissolution of the entity which is the obligor when the obligee has asserted its rights in the dissolution proceedings.**

**(2) Suspension lasts until a final decision has been issued or until the proceedings have been otherwise terminated.**



**COMMENT****1. Judicial proceedings**

In all legal systems judicial proceedings affect the running of a limitation period in either of two manners. Judicial proceedings can cause an interruption of the limitation period, so that a new limitation period begins when the judicial proceedings end. Alternatively, judicial proceedings can cause only a suspension, so that a period that has already lapsed before the judicial proceedings began will be deducted from the applicable period, the remaining period starting at the end of the judicial procedure. This Article adopts the latter solution (see also Article 13 of the UN Limitation Convention).

**2. Commencement of proceedings**

The requirements for the commencement of judicial proceedings are determined by the law of procedure of the court where the proceedings are instituted. The law of procedure of the forum also determines whether the raising of counterclaims amounts to the instituting of judicial proceedings in regard to these claims: where the counterclaims raised as a defence are treated as if they were brought in separate proceedings, raising them has the same effect on the limitation period as if they had been filed independently.

**Illustrations**

1. A purchases from B a truck that turns out to be defective. A notifies B of the defects but, because of other pending contracts between A and B, A does not press the matter for 24 months. When the negotiations between A and B on the other contracts break down, B turns down a request by A to cure the defects, asserting that the defects were caused by A's mishandling of the truck. A files a law suit against B by depositing it with the clerk of the competent court. Under the procedural law applicable in that court, this is sufficient to initiate litigation with respect to A's claims. The running of the limitation period is suspended, until a final decision is handed down. This includes not only a decision of the court of first instance, but also, if appeal is allowed, that of a higher court on any available appeal. If the parties reach a settlement or the plaintiff withdraws its complaint, this ends the litigation if it is so regarded under the applicable domestic procedural law.

2. B initiates litigation for the purchase price of goods by filing a complaint as required by the procedural law of the country of the competent court. A raises claims under an asserted guarantee either as counterclaims or by way of set-off. The limitation period for A's warranty claims is suspended until there is a final decision on the counterclaims or a settlement or withdrawal of A's counterclaims.

### **3. Termination**

"Termination" by a final decision or otherwise is to be determined by the rules of procedure of the forum. These rules decide when a decision is final and therefore brings the litigation on the litigated subject-matter to an end. These rules also have to decide whether and when the litigation comes to an end without a final decision on the merits, e.g. by the withdrawal of a complaint or by a settlement of the parties.

### **4. Suspension by insolvency or dissolution proceedings**

For the purpose of this Article, insolvency and dissolution proceedings are regarded as judicial proceedings (Article 10.5(1)(b) and (c)). The dates of the commencement and ending of these proceedings are determined by the law governing the proceedings.

## **ARTICLE 10.6**

### *(Suspension by arbitral proceedings)*

**(1) The running of the limitation period is suspended when the obligee performs any act, by commencing arbitral proceedings or in arbitral proceedings already instituted, that is recognised by the law of the arbitral tribunal as asserting the obligee's right against the obligor. In the absence of regulations for arbitral proceedings or provisions determining the exact date of the commencement of arbitral proceedings, the proceedings are deemed to commence on the date on which a request that the right in dispute should be adjudicated reaches the obligor.**

**(2) Suspension lasts until a binding decision has been issued or until the proceedings have been otherwise terminated.**

**COMMENT****1. Arbitral proceedings**

Arbitration has the same effect as judicial proceedings. The commencement of arbitral proceedings therefore has the same suspensive effect as judicial proceedings. In general, the date of commencement is determined by the applicable arbitration rules and the starting point of suspension is also determined by these rules. For cases in which the rules on arbitration do not exactly determine the date of commencement of the proceedings, the second sentence of paragraph (1) of this Article provides a default rule.

**Illustration**

A cancels a distributorship contract with B, claiming that B has defaulted payments due for A's delivery of goods to B. B counterclaims damages for lost profits, but B changes its law firm and allows almost 30 months to pass from the termination of the agreement. The agreement contains an arbitration clause, providing that all disputes and claims "shall be settled under the Rules of Conciliation and Arbitration of the International Chamber of Commerce", and B submits a request for arbitration under those rules. The rules provide that the date of receipt of the request is to be regarded "for all purposes" as the date of the commencement of the arbitral proceedings. The running of the limitation period is suspended until a final award is handed down or the case is otherwise disposed of.

**2. Termination of arbitration**

While the most frequent cases of termination will, as in judicial proceedings, be those that end with a decision on the merits of the case, arbitration can also end otherwise, e.g. by the withdrawal of an application, by a settlement or by an order or injunction of the competent court. The applicable rules on arbitration and civil procedure have to determine whether or not such events terminate the arbitration and thereby also the suspension.

**ARTICLE 10.7**

*(Alternative dispute resolution)*

**The provisions of Articles 10.5 and 10.6 apply with appropriate modifications to other proceedings whereby the parties request a third person to assist them in their attempt to reach an amicable settlement of their dispute.**

**COMMENT****1. Alternative dispute resolution**

Before resorting to judicial proceedings or arbitration, parties may start negotiations or agree on conciliation or other forms of alternative dispute resolution.

Under the Principles negotiations do not automatically suspend the limitation period. Parties who want the limitation period to be suspended should come to an express agreement to this effect.

By contrast, this Article provides that conciliation and other forms of alternative dispute resolution cause a suspension of the limitation period. The definition of “alternative dispute resolution” as proceedings whereby the parties request a third person to assist them in their attempt to reach an amicable settlement of their dispute, is inspired by Article 1(3) of the 2002 *UNCITRAL Model Law on International Commercial Conciliation*.

**2. Absence of statutory regulations**

As only few countries have enacted statutes on alternative dispute resolution and rules for such proceedings are relatively rare, this Article refers to the provisions on judicial and arbitral proceedings, which have to be applied with “appropriate modifications”. This means that, in the absence of an applicable legal regulation, the commencement of proceedings of alternative dispute resolution is governed by the default provision in the second sentence of Article 10.6(1), the proceedings starting on the date on which one party’s request to have such proceedings reaches the other party. Since the end of a dispute resolution procedure will very often be uncertain, the reference to Articles 10.5 and 10.6, and in particular to the phrase “until the proceedings have been otherwise terminated” in their paragraphs (2), is also to be applied with appropriate modifications. Thus, a unilateral termination of the dispute resolution procedure by one of the parties

will suffice to terminate the suspension. A unilateral termination that is made in bad faith is subject to Article 1.7.

### Illustration

The parties, a hospital and a supplier of hospital equipment, agree to submit disputes over prices to a board of mediation. Under the applicable rules a review by this board starts on the date on which one party submits a complaint to the other party, who then has to invite the board to review the case under the applicable rules. The mediation ends either when the board decides on the claim, or there is a settlement between the parties, or the claimant's request is withdrawn.

### ARTICLE 10.8

*(Suspension in case of force majeure,  
death or incapacity)*

**(1) Where the obligee has been prevented by an impediment that is beyond its control and that it could neither avoid nor overcome, from causing a limitation period to cease to run under the preceding Articles, the general limitation period is suspended so as not to expire before one year after the relevant impediment has ceased to exist.**

**(2) Where the impediment consists of the incapacity or death of the obligee or obligor, suspension ceases when a representative for the incapacitated or deceased party or its estate has been appointed or a successor has inherited the respective party's position. The additional one-year period under paragraph (1) applies accordingly.**

### COMMENT

#### 1. Effects of impediments

Most legal systems take into account impediments that prevent the obligee from pursuing its rights in court, as does the UN Limitation Convention (see Articles 15 and 21). It is a basic policy concept that

the obligee must have the possibility to pursue its rights before it can be deprived of them as a result of the lapse of time. Practical examples of impediments include war and natural disasters that prevent the obligee from reaching a competent court. Other cases of force majeure may also prevent the pursuance of a right and at least cause the suspension of the limitation period. The impediment must be beyond the obligee's control. Imprisonment, therefore, would suspend the limitation period only where it could not have been avoided, such as in the case of a prisoner of war, but the imprisonment of a criminal would not. Only the general limitation period is suspended, however. If the maximum period has elapsed before the obligee could pursue this right, the obligee is subject to the defence of the expiration of the maximum limitation period.

### **Illustration**

1. A's lawyer plans to file a complaint against B, an engineering firm, for alleged professional malpractice by B's employees. The limitation period will expire on 1 December, and A's lawyer has completed the complaint on 25 November, intending to file it by express mail or in person with the clerk of the competent court. On 24 November, terrorists attack A's country with biological weapons of mass destruction, causing all traffic, mail service, and other social services to completely cease, thus preventing the timely filing of A's complaint. The limitation period ceases to run and will not expire until one year after some means of communication has been restored in A's country. If, however, the disruption of all means of communication in A's country lasts ten years, A's right is barred by the maximum limitation period.

### **2. Additional period of deliberation**

Since impediments beyond the control of the obligee may occur and cease to exist towards the end of the limitation period, it is possible that after the ceasing of the impediment only a very short time or no time at all might be left for the obligee to decide what to do. This Article therefore provides for an additional one-year period of time from the date on which the impediment ceases to exist with a view to enabling the obligee to decide what course of action to take.

### **3. Incapacity and death**

Incapacity and death of the obligee or of the obligor are but special examples of impediments to an effective pursuance of the obligee's right. Paragraph (2) provides for the same solution as in the case of general impediments.

## Illustration

2. A lends B money which is due to be repaid on 1 January. A does not seek repayment for a long time and dies thirty-five months after the date for repayment. The law of succession applicable to A's estate requires that an administrator appointed by the court administer the estate and collect outstanding debts. Since the docket of the competent court is overcrowded, it takes two and a half years for an administrator to be appointed. The administrator has one month left of the three-year general limitation period plus an additional one-year period to pursue the deceased party's claim against B before the limitation period expires.

**ARTICLE 10.9**

*(Effects of expiration of limitation period)*

**(1) The expiration of the limitation period does not extinguish the right.**

**(2) For the expiration of the limitation period to have effect, the obligor must assert it as a defence.**

**(3) A right may still be relied on as a defence even though the expiration of the limitation period for that right has been asserted.**

**COMMENT****1. No extinction of the right**

The expiration of the limitation period does not extinguish the obligor's right, but only bars its enforcement.

**2. Expiration of the limitation period must be raised as a defence**

The effects of the expiration of the limitation period do not occur automatically. They only occur if the obligor raises the expiration as a defence. The obligor can do so in any proceedings in accordance with the applicable law, and also outside of proceedings by invoking the expiration of the limitation period. The existence of the defence can also be the subject of a declaratory judgement.

**Illustration**

1. A purchases goods from B. Part of the purchase price is due on 1 April and is not paid. Thirty-eight months later, B files a complaint against A. A does not invoke the expiration of the limitation period, nor does it appear in court, and B moves for a default-judgment. Judgment will be for B, since A did not raise the expiration of the limitation period as a defence.

**3. Use of a time-barred right as a defence**

Since under the Principles the expiration of a limitation period does not extinguish the right, but only gives a defence that must be asserted by the obligor (paragraphs (1) and (2)), it follows that the obligee's right still exists, although a claim for its performance may be barred by the obligor's assertion of the expiration of the limitation period. It can, therefore, be used as a defence, e.g. as grounds for the retention of performance by the obligee (paragraph (3)).

**Illustration**

2. A leases a printing press to B for ten years. Under the contract A is obliged to maintain the press in working condition and to undertake repairs, unless a defect is caused by B's negligence in operating the machine. The machine breaks down, but A refuses to do the necessary repairs. B, after futile requests and negotiations with A, has the repairs done by another company and asks A to pay the necessary costs. A does not react, and B does not pursue the matter. Five years later, at the end of the lease, B again requests payment of the costs of the repairs. A refuses to pay and invokes Article 10.2(1), requesting the return of the printing press. B is entitled to damages for breach of contract and to withhold delivery of the press.

**ARTICLE 10.10**

*(Right of set-off)*

**The obligee may exercise the right of set-off until the obligor has asserted the expiration of the limitation period.**

**COMMENT**

As the obligee's right continues to exist, it can be used for set-off if the prerequisites of set-off under Article 8.1 are met.



### Illustration

1. The facts are the same as in Illustration 2 to Article 10.9, except that A not only asks for the return of the press, but also for the payment of the unpaid rent. B is entitled to set off its counterclaim for damages against this monetary claim despite the expiration of the limitation period.

Although the expiration of the limitation period does not in itself extinguish the right of the obligee, the situation changes when the obligor invokes the time bar as a defence by asserting it against the obligee. By so doing, the obligor makes the limitation period effective, with the consequence that the right can no longer be enforced. Since set-off may be considered the self-enforcement of a right, it is not available after the defence of the expiration of the limitation period has been invoked.

### Illustration

2. The facts are the same as in Illustration 1, except that B requests the payment of damages and threatens to sue four years after having had the repairs done. A objects, asserting that the machine broke down due to B's fault. Since this is hard to prove, A in a letter to B also invokes the time bar under Article 10.2(1). B can no longer set off its claim for damages.

## ARTICLE 10.11

### *(Restitution)*

**Where there has been performance in order to discharge an obligation, there is no right of restitution merely because the limitation period has expired.**

### COMMENT

#### **1. Time-barred claim as valid basis for performance**

Another consequence of the fact that under the Principles the expiration of the limitation period does not extinguish the right of the obligee but can only be asserted as a defence, is that if the obligor performs despite its defence, the obligation it performs remains effective as a legal basis for the obligee's retaining the performance. Mere expiration of a limitation period cannot be used as grounds for an action to reclaim the performance under restitutionary or unjust enrichment principles.

**2. Restitutionary claims based on other grounds**

Despite the lapse of the limitation period, a restitutionary claim can be based on grounds other than performance, e.g. where a payor claims to have paid a non-existing debt due to a mistake.

**Illustrations**

1. Bank B lends money to borrower A, who does not repay on the date required by the loan agreement. A's debt is overlooked and forgotten because of a book-keeping error on the part of B. Four years later, B discovers its error and sends A a notice claiming repayment. A complies with this request, but later learns from a lawyer that it could have refused repayment on account of the expiration of the limitation period. A cannot reclaim the payment as unjust enrichment from B.
2. The facts are the same as in Illustration 1, except that A has in fact repaid the loan, but both sides are unaware of this. Four years later, B erroneously requests payment from A, and A complies. A can recover the second payment because A has already paid a debt which has thus been extinguished by full performance.

## **CHAPTER 11**

### **PLURALITY OF OBLIGORS AND OF OBLIGEEES**

#### **SECTION 1: PLURALITY OF OBLIGORS**

##### **ARTICLE 11.1.1** *(Definitions)*

**When several obligors are bound by the same obligation towards an obligee:**

**(a) the obligations are joint and several when each obligor is bound for the whole obligation;**

**(b) the obligations are separate when each obligor is bound only for its share.**

##### **COMMENT**

This Chapter deals with situations where an obligation binds several obligors or gives rights to several obligees.

Section 1 concerns the plurality of obligors.

#### **1. Several obligors**

There are frequent cases when an obligation binds several obligors.

##### **Illustrations**

1. Companies A, B and C decide to join efforts to penetrate a new market abroad. They need financing and they obtain a loan together from bank X. A, B and C are co-obligors of the obligation to reimburse the loan.
2. Contractors A and B are awarded a contract for the construction of a bridge based on a submission they have filed together. A and B are co-obligors of the obligation to build the bridge.

3. A large industrial plant has to be insured against fire and other hazards. The risk is too large for the capacity of any single insurer. Several insurers co-insure the risk. These insurers are co-obligors of the obligation to cover the risk.

4. Bank X grants a loan to company A but requires a guarantee. Parent company B agrees to bind itself together with A for the reimbursement of the loan. A and B are co-obligors of the obligation to reimburse the loan.

## **2. The same obligation**

This Section only applies if the different obligors are bound by the same obligation.

It also frequently happens that several obligors are involved in the same operation, but with distinct obligations. They are not co-obligors under the Articles of this Section.

### **Illustration**

5. A new aeroplane is being built. Many sub-contractors are involved in the various elements. For instance, sub-contractor A is in charge of profiling the wings and sub-contractor B of studying the electronic equipment. Their respective obligations are different. They are not “co-obligors”.

The “same obligation” usually, but not necessarily, arises from a single contract. In Illustrations 1 and 2, there will normally be a single loan contract, or a single construction contract binding the different obligors. However, in the case of co-insurance (Illustration 3), it is frequent that each insurer, even though undertaking to cover the same risk, has its own distinct contract with the insured. The guarantee offered in Illustration 4 will often be granted in a distinct contract. Other examples of obligations undertaken by a different contract are cases in which obligations are transferred by agreement (see Article 9.2.1 *et seq.*).

However, the obligations concerned must be contractual, irrespective of whether they arise from a single contract or out of several contracts. Tortious obligations of multiple tortfeasors are not governed by this Chapter, since the Principles govern international commercial contracts. Contractual damage claims may fall under this Chapter.

### 3. Two main types of obligation

Article 11.1.1 defines the two main types of obligation which exist in practice when several obligors are bound by the same obligation towards an obligee.

The first is where each obligor is bound for the whole obligation, which means that the obligee may require performance from any one of them (see Article 11.1.3), subject to contributory claims between the obligors at a later stage (see Article 11.1.10).

The second is where each obligor is bound only for its share, which entitles the obligee to claim only that much from each of the obligors.

In the former situation, which is the default rule (see Article 11.1.2), obligations are called “joint and several”. In the latter situation, obligations are called “separate”.

Whether co-obligors are jointly and severally, or separately bound is determined in accordance with Article 11.1.2 (see Illustrations 1 to 4).

### 4. Other possible situations

The two main types of obligation illustrated above are the most common, but this Section does not intend to cover all possible arrangements.

Other situations which can occur are those of so-called “joint” or “communal” obligations, in which the obligors are bound to render performance together and the obligee may claim performance only from all of them together. A typical example is that of a group of musicians having undertaken to perform a string quartet. Situations of this type are of less practical importance.

#### ARTICLE 11.1.2

*(Presumption of joint and several obligations)*

**When several obligors are bound by the same obligation towards an obligee, they are presumed to be jointly and severally bound, unless the circumstances indicate otherwise.**

**COMMENT****1. Default rule**

In commercial practice the normal case is that several obligors that have undertaken the same obligation are jointly and severally bound towards the obligee. This justifies the default rule expressed in Article 11.1.2.

**Illustration**

1. Companies A, B and C have together obtained a loan from bank X (as in Illustration 1 under Article 11.1.1). The loan contract fails to indicate how each of the parties is bound. They are presumed to be joint and several obligors, i.e. towards the bank each of them is bound for the whole amount of the loan.

**2. Circumstances indicating otherwise**

The presumption of joint and several obligations is rebutted when the circumstances indicate otherwise. This will often be the result of an explicit contractual provision to the contrary.

**Illustration**

2. Insurers A, B and C have agreed to co-insure an industrial plant (as in Illustration 3 under Article 11.1.1). The scheme provides that each co-insurer is only bound for a percentage of the risk.

Other circumstances can also discard the presumption that plural obligors are jointly and severally bound.

**Illustration**

3. The facts are the same as in Illustration 2, but insurers A, B and C have omitted to stipulate that they are not jointly and severally bound. However, the very purpose of co-insurance is to cover large risks without putting any insurer beyond the limits of its own capacity. This may be considered as a circumstance indicating that A, B and C are only bound for their respective shares.

**3. Suretyship and joint and several obligations**

A different situation is that of suretyship, an accessory agreement by which a person binds itself for another already bound, in case the main obligor defaults. The surety is not bound as a principal, but will only have to perform if the main obligor fails to do so. Principal and surety are bound separately – and in a successive order.

## Illustration

4. Company A wants to borrow EUR 1,000,000 from bank X. The loan is granted on the condition that parent company B will act as surety for reimbursement of the loan. A is X's main obligor. B will be required to pay only if and when A defaults.

It may happen that the technique of joint and several obligations is used as a mechanism by which the economic benefit of suretyship may be obtained. The obligee requests the company willing to guarantee the initial obligor's obligation to intervene next to the latter as a joint and several obligor, instead of entering into a separate agreement of suretyship. The obligee's advantage is that in such a case, it can require payment directly from the intervening company. This does not necessarily deprive the intervening company of the special rights provided to a surety under the law of suretyship.

## Illustration

5. The facts are the same as in Illustration 4, but X requires B to bind itself as a joint and several obligor, next to A, for reimbursement of the loan. X may then require reimbursement directly from B as well as from A.

This particular use of the technique of joint and several obligations has some specific consequences: see Comment 3 to Article 11.1.9, concerning apportionment among joint and several obligors. The law of suretyship may, of course, provide additional consequences.

**ARTICLE 11.1.3**

*(Obligee's rights against joint  
and several obligors)*

**When obligors are jointly and severally bound, the obligee may require performance from any one of them, until full performance has been received.**

## COMMENT

The main effect of joint and several obligations from the obligors' point of view has already been stated in the definition given in Article 11.1.1, namely that each obligor is bound for the whole obligation.

Article 11.1.3 states the main effect for the obligee: it may require performance from each obligor, until full performance has been received.

## Illustrations

1. Farmers A, B and C have bought a tractor together, for shared use in their respective fields. They are jointly and severally bound to pay the price of USD 45,000. Seller X may require payment of the whole sum from A, B or C. X's claim is extinguished when it has received full performance, from one or more of its obligors.
2. The facts are the same as in Illustration 1. A pays only USD 30,000 (in spite of being bound for USD 45,000). X, while still retaining a claim against A for the unpaid part, may claim that amount of USD 15,000 from B or C. If X, at this stage, only receives USD 10,000 from B (though B was still bound for USD 15,000), X may still claim USD 5,000 from C, as well as from A and B.

## ARTICLE 11.1.4

*(Availability of defences and rights of set-off)*

**A joint and several obligor against whom a claim is made by the obligee may assert all the defences and rights of set-off that are personal to it or that are common to all the co-obligors, but may not assert defences or rights of set-off that are personal to one or several of the other co-obligors.**

## COMMENT

This Article deals with the possibilities for a joint and several obligor to assert different defences and rights of set-off. It distinguishes between, on one side, defences and rights of set-off that are personal to one of the obligors or common to all of them, and, on the other side, defences and rights of set-off which are personal to one or several of the other co-obligors.



## Illustrations

1. Together, companies A, B and C have purchased machinery from manufacturer X, to be used in their respective plants for a common project. Part of the purchase price has to be paid at a future date, the outstanding amount being jointly and severally due. A has obtained a separate undertaking from X that the machinery would meet a certain performance level. If X requires A to pay the outstanding amount of the price, A may assert the fact that the machinery does not meet the guaranteed level of performance. On the other hand, if X claims payment from B and C, the latter may not assert that the level of performance is insufficient, since the defence is personal to A.
2. Companies A and B jointly and severally have undertaken to purchase a certain quantity of steel from seller X. Government authorities in the buyers' country declare an embargo on all trade with the seller's country, which renders performance of the contract unlawful. This is a common defence which each of the co-obligors may assert against X.
3. Bank X has lent EUR 2,000,000 to joint and several obligors A and B. As a result of the selling of shares belonging to A on the stock market, X becomes A's obligor for an amount of EUR 500,000. A may exercise its right of set-off against X, with the effects provided for in Article 11.1.5. On the contrary, B may not assert this right, which is personal to A.

**ARTICLE 11.1.5***(Effect of performance or set-off)*

**Performance or set-off by a joint and several obligor or set-off by the obligee against one joint and several obligor discharges the other obligors in relation to the obligee to the extent of the performance or set-off.**

**COMMENT****1. Performance by a joint and several obligor**

If one of the co-obligors has already fully or partially performed the obligation, the other obligors may successfully assert this as a defence should the obligee still attempt to claim performance from the other co-obligors.

**Illustrations**

1. Companies A, B and C are jointly bound to reimburse a loan of EUR 100,000. Upon lender X's request, A fully reimburses the loan. B and C can avail themselves of A's performance if X still claims reimbursement of the loan from them.
2. The facts are the same as in Illustration 1, but A only reimburses EUR 30,000. B and C are still jointly and severally bound for EUR 70,000 (see Article 11.1.3), but they may invoke A's partial payment if X still claims the full amount from them.

**2. Set-off**

The rule laid down in this Article with respect to performance by one of the co-obligors also applies, with appropriate adaptations, in the case of set-off between the obligee and one of the obligors. Rights of set-off have already been mentioned in Article 11.1.4, where the issue is to determine which of the co-obligors could assert rights of set-off. Article 11.1.5 deals with the subsequent issue of the effects of set-off, once it has been exercised. On the rules governing set-off itself, see Articles 8.1 to 8.5.

**Illustration**

3. The facts are the same as in the preceding illustrations: A, B and C are jointly bound to reimburse a loan of EUR 100,000 to X. However, on the basis of a different transaction A has become X's obligee for an amount of EUR 60,000. If A exercises its right of set-off against X by serving appropriate notice (as provided in Article 8.3), it will have the same effect as partial performance by A of its joint and several obligation, thus discharging B and C for the corresponding amount.

The same rule applies if the right of set-off has been exercised by the obligee against one of the joint and several obligors.

**Illustration**

4. The facts are the same as in Illustration 3, but it is X who takes the initiative to give the set-off notice to A. The effects are identical. A is discharged for the amount of set-off (EUR 60,000), and the other co-obligors B and C are also discharged for the same amount.

**ARTICLE 11.1.6***(Effect of release or settlement)*

**(1) Release of one joint and several obligor, or settlement with one joint and several obligor, discharges all the other obligors for the share of the released or settling obligor, unless the circumstances indicate otherwise.**

**(2) When the other obligors are discharged for the share of the released obligor, they no longer have a contributory claim against the released obligor under Article 11.1.10.**

**COMMENT****1. Release of one joint and several obligor**

If the obligee releases one of its joint and several obligors with no further qualifications, Article 11.1.6 provides as the default rule that the release affects only the share of the released obligor, as determined by Article 11.1.9. As a consequence, the other obligors are discharged for the share of the released obligor only, and remain bound for the difference.

**Illustration**

1. Bank X lends EUR 300,000 to companies A, B and C. The obligors are jointly and severally bound; their respective contributory shares are equal, i.e. EUR 100,000 each. X releases A, with no further qualification. The consequence for B and C is that they are released for the amount of A's share of EUR 100,000. B and C remain jointly and severally bound towards X for an amount of EUR 200,000.

**2. Settlement with one joint and several obligor**

Sometimes the obligee receives payment from one of the co-obligors of an amount less than that obligor's share as determined by Article 1.9, as part of a separate settlement with that obligor, pursuant to which the payment received is accepted as discharging all of the settling obligor's share. Consequently, the other obligors' joint and several obligations are reduced not only by the amount paid, but by the full initial amount of the settling obligor's share.

**Illustration**

2. Investors A, B and C are jointly and severally bound to pay seller X USD 3,000,000 for an acquisition of shares. A and X come to a settlement of different disputes between themselves. One of the terms of the settlement is that A will be discharged of its obligations towards X under the share purchase agreement by paying an amount of USD 600,000, i.e. USD 400,000 less than A's contributory share towards the other co-obligors. Under these circumstances, X may not claim the whole remaining USD 2,400,000 against B and C. Their joint and several obligations are reduced by the full initial amount of A's share, i.e. USD 1,000,000. They are still jointly and severally bound for USD 2,000,000 only.

**3. Circumstances indicating otherwise**

There can be circumstances where the other obligors are discharged for another amount other than that of the released or settling obligor's share.

For instance, the obligee may release one of its obligors only for part of the latter's share, as determined by Article 11.1.9. The other obligors will be discharged only for the amount of that released part. All obligors will remain jointly and severally bound for the reduced total amount.

**Illustration**

3. The facts are the same as in Illustration 1, except that X releases A for an amount of EUR 60,000. The consequence for B and C is that they are released for the same amount of EUR 60,000. A, B and C remain jointly and severally bound towards X for an amount of EUR 240,000.

On the other hand, the obligee may also intend to fully release all of its obligors. If the obligee expresses its intention so to do, Article 11.1.6 does not apply.

As to settlement, it will frequently not be separate, but concern all joint and several obligors. The consequences for the different obligors' obligations will in these cases be determined by the terms of the settlement agreed by all parties, and the contributory claims will be adjusted accordingly.

**4. No more contributory claim**

If the obligee has released one of the co-obligors, or settled with it, and the other co-obligors have been discharged of the released obligor's share, the other co-obligors have no more contributory claim against the released obligor.

## Illustrations

4. The facts are the same as in Illustration 1: A is released by X, while B and C remain jointly and severally bound for an amount of EUR 200,000. If B pays X EUR 200,000, B has a contributory claim of EUR 100,000 against C, but no claim against A.
5. The facts are the same as in Illustration 2: B and C continue to be jointly and severally bound for an amount of USD 2,000,000. If B pays USD 2,000,000 to X, B has a contributory claim of USD 1,000,000 against C; but B has no claim against A, even though A has paid X only USD 600,000 as agreed in their separate settlement.

**ARTICLE 11.1.7**

*(Effect of expiration or suspension  
of limitation period)*

**(1) Expiration of the limitation period of the obligee's rights against one joint and several obligor does not affect:**

- (a) the obligations to the obligee of the other joint and several obligors; or**
- (b) the rights of recourse between the joint and several obligors under Article 11.1.10.**

**(2) If the obligee initiates proceedings under Articles 10.5, 10.6 or 10.7 against one joint and several obligor, the running of the limitation period is also suspended against the other joint and several obligors.**

**COMMENT****1. Expiration of the limitation period against one obligor**

The obligee's rights against one (or several) of the joint and several obligors may become time-barred. This does not prevent the obligee from exercising its claim against the other co-obligors whose obligations are not yet affected by the expiration of a period of limitation.

**Illustration**

1. Companies A and B are jointly and severally bound to pay consultant X fees of USD 500,000 on 1 January. A and B refuse to pay, arguing that the services rendered by X were unsatisfactory. The parties enter into lengthy discussions. Two years later, in the course of the year B comes to acknowledge X's rights, but A continues to challenge them. In March the following year X finally sues both clients for payment. More than three years after the date when X's fees were due (see Article 10.2), X's claim against A is time-barred. The situation is different for B, who acknowledged the right of the obligee before the expiration of the limitation period, thus triggering the running of a new period (see Article 10.4). X can still claim USD 500,000 from B.

Co-obligors who have paid the obligee under such circumstances can exercise their rights of recourse in accordance with Article 11.1.10, even against the co-obligor who could avail itself of the expiration of a period of limitation against the obligee, in accordance with Article 10.9. These rights of recourse are subject to their own limitation periods.

**Illustration**

2. In the case described in Illustration 1, B, after paying USD 500,000 to X, can claim contribution from A under Article 11.1.10.

**2. Suspension of the limitation period against one obligor**

Initiation by the obligee of legal or arbitral proceedings or an ADR procedure against one of the joint and several obligors suspends the running of the limitation period against that obligor under Articles 10.5, 10.6 or 10.7. Article 11.1.7(2) extends the effect of the suspension to the other co-obligors.

**Illustration**

3. Co-buyers A and B are jointly and severally bound to pay seller X a sum of GBP 800,000, which was due on 31 December. In spite of several reminders, A and B are still in default close to the end of the three-year limitation period. On 20 December three years later X initiates legal proceedings against A. The limitation period is suspended not only against A, but also against B.

The rule in Article 11.1.7(2), which creates effects towards all co-obligors, adopts an approach different from that in the rule in Article 11.1.7(1), which provides for individual effects. Indeed, different effects are concerned: those of expiration of the limitation period and those of initiating legal proceedings. The solution adopted in paragraph (2) saves the expenses involved in initiating proceedings against all obligors. The obligee should however keep in mind the rule in Article 11.1.8 concerning effect of judgments.

#### **ARTICLE 11.1.8**

*(Effect of judgment)*

**(1) A decision by a court as to the liability to the obligee of one joint and several obligor does not affect:**

**(a) the obligations to the obligee of the other joint and several obligors; or**

**(b) the rights of recourse between the joint and several obligors under Article 11.1.10.**

**(2) However, the other joint and several obligors may rely on such a decision, except if it was based on grounds personal to the obligor concerned. In such a case, the rights of recourse between the joint and several obligors under Article 11.1.10 are affected accordingly.**

#### **COMMENT**

##### **1. No effect on the other obligors' obligations**

If the obligee commences judicial or arbitral proceedings against only one (or some) of the joint and several obligors, any decision by the court will not in principle affect the obligations of the co-obligors who were not called to court. Whatever the decision, the other obligors will still be bound in the original terms.

#### **Illustrations**

1. Bank C has loaned EUR 1,000,000 to joint and several borrowers A and B. A is sued for reimbursement by X and the court orders A to pay X EUR 1,000,000. This decision in itself

does not affect B's obligation; B is still bound to pay EUR 1,000,000 to X. Naturally, if the judgment is enforced and A pays X EUR 1,000,000, B's obligation towards X will be extinguished under Article 11.1.5 and B will be subject to A's contributory recourse under Article 11.1.10.

2. Company A and company B have jointly and severally undertaken to provide transportation for company X's deliveries to its clients. Performance is defective and X sues A. The court orders A to pay damages. B is not bound by that finding of defective performance, and its obligations are not increased by the amount of the damages.

## **2. No effect on the rights of recourse**

A court decision rendered against one joint and several obligor furthermore has no effect on the rights of recourse between the joint and several obligors under Article 11.1.10.

### **Illustration**

3. The facts are the same as in Illustration 2. A pays X the damages ordered by the court. A may not claim to recover part of the damages from B.

## **3. Right of the other joint and several obligors to avail themselves of the decision**

The principle stated in paragraph (1) of this Article does not have to be enforced when the other co-obligors find it in their interest to rely on the decision. For such cases, paragraph (2) grants the other joint and several obligors the right to rely on it. However, the rule does not apply when the decision was based on grounds personal to the obligor concerned.

### **Illustrations**

4. Art collectors A and B have joined in purchasing a painting at an auction and they are jointly and severally bound to pay the price of GBP 800,000. The price is not paid and the auction house sues A. The court accepts some of A's arguments concerning the quality of the painting, which appears to have been restored, and reduces the price to GBP 600,000. B may rely on that decision to benefit from the same reduction of its obligations towards the auction house.

5. The facts are the same as in Illustration 4, except that A's refusal to pay the auction house is grounded on a claim that the painting is a fake. This is confirmed by an expert opinion ordered



by the court. Accordingly, the contract is avoided. B may also rely on that decision to be discharged of its obligations towards the auction house.

6. The facts are the same as in Illustration 4, except that A had separately obtained from the auction house a certificate stating that the painting had been shown at some major exhibitions. This turns out to be untrue, and a court orders the auction house to pay damages to A. B may not rely on that decision, since it is based on grounds personal to A.

#### **4. Rights of recourse affected accordingly**

If a joint and several obligor avails itself of a court decision rendered against its co-obligor, the right of recourse of the co-obligor will be affected accordingly.

#### **Illustration**

7. The facts are the same as in Illustration 4. A's obligation towards the auction house has been reduced to GBP 600,000. If A, after having paid this amount to the auction house, initiates a contributory recourse against B, the latter may avail itself of the court decision to have its contributory share reduced accordingly.

### **ARTICLE 11.1.9**

*(Apportionment among joint and several obligors)*

**As among themselves, joint and several obligors are bound in equal shares, unless the circumstances indicate otherwise.**

#### **COMMENT**

Articles 11.1.9 to 11.1.13 of this Section deal with contributory claims. An obligor who has performed the obligation in favour of the obligee has a claim against the other joint and several obligors to recuperate their respective shares.

The first issue is to determine these respective shares. As a default rule, Article 11.1.9 states that these shares are equal.

**Illustration**

1. Companies A and B have borrowed EUR 10,000,000 from Bank X to finance the acquisition of stock in another company. In principle, A's and B's shares in the final allocation will be EUR 5,000,000 each.

However, circumstances can indicate otherwise, i.e. that the shares are unequal. This will often result from the contractual arrangements between the co-obligors.

**Illustration**

2. The facts are the same as in Illustration 1, except that A and B have agreed that their respective participations in the acquisition would be 75% and 25%. There is a presumption that these percentages will also govern the final allocation.

The circumstances may indicate that some obligors are ultimately to bear the whole amount of the obligation. This is the case when a party agrees to be bound as joint and several obligor not because of its own interest in the operation, but to serve as guarantor for the other ("main") obligor (see Comment 3 on Article 11.1.2).

**Illustration**

3. Company A applies for a loan of EUR 10,000,000 from bank X. The loan is granted on the condition that company B intervene as joint and several obligor. As between the two companies, it is understood that B only serves as a guarantor. The circumstances indicate that the shares in the final allocation should be 100 % for A and 0 % for B.

**ARTICLE 11.1.10**

*(Extent of contributory claim)*

**A joint and several obligor who has performed more than its share may claim the excess from any of the other obligors to the extent of each obligor's unperformed share.**

**COMMENT**

After a joint and several obligor has paid more than its share to the obligee, it has contributory claims against the other obligors to recover the excess, on the basis of the respective shares.

**Illustrations**

1. Companies A and B have borrowed EUR 10,000,000 from bank X to finance the acquisition of stock in another company. A's and B's shares are in principle equal. If A has reimbursed the full amount to X, it can claim contribution from B for the amount in excess of A's own share of 50 %, i.e. EUR 5,000,000.
2. The facts are the same as in Illustration 1, except that A and B have agreed that their respective participations in the acquisition would be 75% and 25%. If A has ultimately to bear 75% of the reimbursement, A can only recuperate the excess, i.e. B's share of EUR 2,500,000.
3. Company A applies for a loan of EUR 10,000,000 from bank X. The loan is granted on the condition that company B intervene as a joint and several obligor. As between the two companies, it is understood that B only serves as a guarantor. A's share is 100 %. If B has repaid the loan to X, B can claim full reimbursement from A.

The rule in Article 11.1.10 can also apply in more complex circumstances.

**Illustration**

4. Investors A, B and C have joined efforts to buy an office building. The total price amounts to USD 1,000,000 but the respective agreed shares are 50%, 30% and 20%. The seller is entitled to request payment of USD 1,000,000 from any of the obligors but it can only recover USD 650,000 from A; the seller then recovers the remaining USD 350,000 from B. A has paid USD 150,000 in excess of its share of USD 500,000; B has paid USD 50,000 in excess of its share of USD 300,000. C's share, on the other hand, is totally unpaid. A and B will respectively have contributory claims of USD 150,000 and USD 50,000 against C.

Articles 11.1.6(2), 11.1.7(1)(b) and 11.1.8(b) provide for particular rules on the availability of contributory claims under the circumstances respectively governed by these provisions.

**ARTICLE 11.1.11***(Rights of the obligee)*

**(1) A joint and several obligor to whom Article 11.1.10 applies may also exercise the rights of the obligee, including all rights securing their performance, to recover the excess from all or any of the other obligors to the extent of each obligor's unperformed share.**

**(2) An obligee who has not received full performance retains its rights against the co-obligors to the extent of the unperformed part, with precedence over co-obligors exercising contributory claims.**

**COMMENT****1. Subrogation in the obligee's rights**

A joint and several obligor who has paid more than its share to the obligee has a contributory claim against the other obligors under Article 11.1.10. Article 11.1.11(1) gives the co-obligor who has such a contributory claim the possibility of benefiting from the rights of the obligee, including all rights securing their performance. This possibility is of particular value to the joint and several obligor when the rights of the obligee are secured, because the contributory right under Article 11.1.10 is not secured.

**Illustration**

1. Bank X has lent EUR 500,000 to companies A and B as joint and several obligors, secured by a mortgage on A's premises. B reimburses the full amount of the loan. Under Article 11.1.10, B has an unsecured claim against A for contribution in the amount of EUR 250,000. B may also exercise X's rights against A up to the amount of EUR 250,000, including enforcement of the mortgage on A's premises.

**2. Obligee's rights reserved and preferred**

By providing that an obligee who has not received full performance retains its rights against the joint and several obligors, and by giving those retained rights of the obligee precedence over the rights of the performing obligor, the rule in Article 11.1.11(2) assures that the

benefit given to the joint and several obligor in Article 11.1.11(1) does not detrimentally affect the remaining rights of the obligee. This precedence may be effectuated by deferring enforcement of the claim of the performing joint and several obligor under Article 11.1.11(1) until full performance is received by the obligee.

#### Illustration

2. The facts are the same as in Illustration 1, except that B has reimbursed only EUR 400,000 of the loan, and the remaining EUR 100,000 remain unpaid. B has a contributory claim against A for the amount in excess of its own share, i.e. EUR 150,000 (EUR 400,000 - EUR 250,000). B also has the right to exercise X's rights against A up to that amount, including enforcement of the mortgage on A's premises. However, as X's rights with respect to the remaining EUR 100,000 have precedence over the rights of B, enforcement of B's rights against A may not occur until after X has received repayment of the remaining EUR 100,000.

The rule on precedence is subject to the possible application of mandatory rules providing otherwise in insolvency proceedings.

#### ARTICLE 11.1.12

*(Defences in contributory claims)*

**A joint and several obligor against whom a claim is made by the co-obligor who has performed the obligation:**

**(a) may raise any common defences and rights of set-off that were available to be asserted by the co-obligor against the obligee;**

**(b) may assert defences which are personal to itself ;**

**(c) may not assert defences and rights of set-off which are personal to one or several of the other co-obligors.**

#### COMMENT

This provision deals with the defences and rights of set-off that may be asserted between co-obligors when contributory claims are exercised.

**1. Common defences and rights of set-off**

Pursuant to Article 11.1.4, the co-obligor that is asked to perform by the obligee may assert all defences and rights of set-off common to all the co-obligors. If that co-obligor has failed to raise such a defence or right of set-off which would have extinguished or reduced the obligation, any other joint and several obligor against which the former obligor exercises a contributory claim may assert that defence or right of set-off.

**Illustration**

1. Joint and several obligors A and B have purchased a know-how licence together. Licensor X has undertaken that the technology was fit for both licencees. If this appeared not to be the case, each obligor could invoke this common defence against X. If A fails to do so when required to pay the fees by X, B may refuse to pay its contributory share to A.

**2. Personal defences**

A co-obligor may also assert a defence personal to itself against a contributory claim.

**Illustration**

2. Companies A, B and C are jointly and severally bound to pay the price of products to be purchased from seller X. A, however, was induced to enter the contract by fraud within the meaning of Article 3.8. B pays the full price to X. A may assert the fraud it had been subjected to as a personal defence against B's contributory claim.

Under Article 11.1.12, rights of set-off are not subject to the same rule as defences, as they usually are in the Principles. The reason for this is that the rights of set-off cannot be treated in the same manner as defences when it comes to the asserting of a personal right of set-off against the obligee to counter a contributory claim. In actual fact, under Article 11.1.5, performance by the other co-obligor has discharged the first obligor from its obligations towards the obligee, with the consequence that the right of set-off does not exist any more. The first obligor will have to pay its contributory share to the other obligor, while remaining in a position to exercise its distinct claim against the obligee.

### Illustration

3. Bank X has lent EUR 3,000,000 to joint and several obligors A and B. As a result of the selling of shares belonging to A on the stock market, X then becomes A's obligor for an amount of EUR 500,000, thus giving A a right of set-off for that amount. X claims reimbursement of EUR 3,000,000 from B, which pays the full amount. If B then claims contribution from A, the latter may not assert its own right of set-off against B. Such a right does not exist any more since payment to X by B has also discharged A towards X. A will have to pay its contributory share to B and will be able to exercise its own claim of EUR 500,000 against X.

### 3. Defences and rights of set-off personal to other co-obligors

A co-obligor may not assert a defence or right of set-off which is personal to one or several of the other co-obligors.

### Illustrations

4. The facts are the same as in Illustration 2. If B claims contribution against C, the latter may not invoke the fraud to which A was subject, since this defence is personal to A.

5. The facts are the same as in Illustration 3. If B claims contribution from C, the latter may not assert A's right of set-off, since this right is personal to another obligor.

### ARTICLE 11.1.13

*(Inability to recover)*

**If a joint and several obligor who has performed more than that obligor's share is unable, despite all reasonable efforts, to recover contribution from another joint and several obligor, the share of the others, including the one who has performed, is increased proportionally.**

### COMMENT

#### 1. Proportional sharing of the loss

A co-obligor exercising a contributory claim against another co-obligor may be unable to recover because the latter is insolvent or has

disappeared or its assets are out of reach. In this case the burden of the loss is spread among the other co-obligors.

#### **Illustration**

1. Companies A, B and C borrow EUR 6,000,000 from bank X, their contributory shares being equal. After reimbursing the loan, A claims EUR 2,000,000 from B and EUR 2,000,000 from C. B turns out to be insolvent. The loss of EUR 2,000,000 has to be borne proportionally by the other co-obligors, including the one who has performed. Since their shares are identical, both A and C will bear an equal part of the loss, i.e. EUR 1,000,000 each. Consequently, A can recover EUR 3,000,000 from C.

#### **2. All reasonable efforts**

Before invoking this Article in order to claim increased contributions from the other co-obligors, the obligor who has performed must exert all reasonable efforts to recover from the defaulting co-obligor in the light of Article 5.1.4(2).

#### **Illustration**

2. The facts are the same as in Illustration 1. A does not question B's assertion that it is unable to pay because of financial difficulties and immediately asks for an increased contribution from C. However, in order to avail itself of Article 11.1.13, A must demonstrate that it has exerted all reasonable efforts to recover from B, such as reminders, injunctions, attachments or legal proceedings, as may be appropriate.



## **SECTION 2: PLURALITY OF OBLIGEES**

### **ARTICLE 11.2.1**

#### *(Definitions)*

**When several obligees can claim performance of the same obligation from an obligor:**

**(a) the claims are separate when each obligee can only claim its share;**

**(b) the claims are joint and several when each obligee can claim the whole performance;**

**(c) the claims are joint when all obligees have to claim performance together.**

#### **COMMENT**

##### **1. Several obligees**

Plurality of obligees occurs in different situations.

##### **Illustration**

1. Banks A, B and C join in a syndicated loan agreement to lend company X USD 12,000,000. The three banks are plural obligees with regard to claiming reimbursement from X.

Other instances of plurality of obligees occur, among others, with co-insurers, multiple buyers and/or sellers in share acquisition agreements and partners in consortium agreements in various sectors, such as the construction sector or the petroleum industry.

##### **2. The same obligation**

This Section applies when the different obligees can claim performance of the same obligation from the obligor. This is the case in Illustration 1 (reimbursement of the syndicated loan). Situations where different obligees of the same obligor have rights deriving from different obligations do not fall under the scope of this Section.

**Illustration**

2. Architect A and contractor B are both involved in the construction of a new industrial plant. Their respective claims against the client concern different obligations (payment of their respective types of services). The claims are not subject to the Articles in this Section, but to the respectively applicable law.

On the other hand, when different actors in a construction project join in a consortium and claim one payment for all their services, they are to be considered as plural obligees for that payment.

The “same obligation” usually derives from a single contract. In Illustration 1, the syndicated loan agreement is a single contract. It could however also happen, in the same situation, that each lender would choose to have its own contract with the borrower. Co-insurers joining to cover the same risk usually have distinct contractual relationships with the insured.

**Illustration**

3. Eight insurance companies agree to co-insure the liability risks of a pharmaceutical group. The co-insurance agreement provides that each co-insurer has a distinct contractual relationship with the insured, but the insured’s obligations towards the co-insurers are the same (payment of the agreed premium, required prevention measures, loss notification, etc.). These co-insurers are plural obligees, subject as such to the Articles in this Section.

**3. Three main types**

Article 11.2.1 defines three main types of claims available in practice when several obligees can claim performance of the same obligation from an obligor.

The claims can be separate. Each obligee can then claim only its share.

**Illustration**

4. The facts are the same as in Illustration 1. If the claims of banks A, B and C against X totalling USD 12,000,000 are separate and if their shares are equal, each bank may only claim reimbursement of USD 4,000,000 from X.

The claims can be joint and several, which means that each obligee can claim full performance (see Article 11.2.2), subject to subsequent allocation between the different obligees (see Article 11.2.4).

### Illustration

5. Companies A and B are co-owners of a storage house, which they rent to transport company X. The contract provides that the co-owners' claims for the rent are joint and several. A and B may each claim payment of the full amount of the rent from X.

The claims are “joint” when all obligees have to claim together; consequently, the obligor may only perform in favour of all of them together. This situation is sometimes also referred to as “communal claims”.

### Illustration

6. Companies A and B rent an office together, to share in a foreign capital. Due to the nature of their claim on occupation of the office, A and B are joint obligees. This would not prevent them from designating one of them as agent for dealings with the owner of the premises.

## 4. No presumption provided

In the case of plurality of obligors, Article 11.1.2 sets a presumption of joint and several obligations, because this corresponds to the most frequent commercial practice.

On the contrary, when it comes to determining to which of the three types defined in this Article claims by plural obligees belong, the Principles do not provide any presumption. The reason is that none of these types seems to be dominant in practice; choices vary considerably, mainly depending on the operation concerned.

Consequently, in situations where plural obligees are involved, parties are encouraged to choose the relevant type by an express stipulation.

### Illustrations

7. Banks A, B and C join in a syndicated loan agreement to offer financing to company X. The agreement provides that “All amounts due, and obligations owed, to each Bank are separate and independent obligations. Each Bank may separately enforce its rights under this agreement”. This express provision makes the banks' claims separate.

8. Art collectors A and B, co-owners of a painting by Rothko, sell it to a Museum for the price of USD 20,000,000. The contract stipulates that each seller can claim payment of the whole price. The claims are joint and several.

9. The facts are the same as in Illustration 8, except that the sales contract with the Museum provides that A and B's claims are separate. This means that each of them can only claim payment of the price for its own share of the claim, normally corresponding to its previous share of ownership.

Before making such a contractual choice, parties should pay attention to the advantages and disadvantages of each of the different types of plural claim.

In particular, joint and several claims have the advantage of avoiding the multiplication of law suits. This is an especially important concern in international trade. Any of the obligees may claim the whole performance. Joint and several claims also simplify the situation of the obligor, who will not have to divide performance between its different obligees. From the point of view of the plural obligees themselves, claims are normally easier if they are joint and several.

On the other hand, plural obligees have to be aware that if their claims are joint and several they lose exclusive control of their respective shares. Any other joint and several obligee may claim and collect the whole performance, with the risk that later allocation under Article 11.2.5 could create difficulties. This explains why separate claims seem to be more prevalent in certain sectors (see for instance Illustration 1).

If the parties have failed to make an explicit contractual choice, the type to which a plural claim should be assigned will be determined by interpretation of the contract in accordance with the provisions in Chapter 4. In many instances circumstances such as the nature or the purpose of the contract will be especially relevant (see Article 4.3 (d)).

### Illustrations

10. Company A, located in country X, and company B, located in country Y, join in ordering a large quantity of cars from a manufacturer. The cars for country X are right-hand drive, those for country Y left-hand drive. When delivery is to be claimed, these circumstances indicate that A and B are separate obligees, each one being entitled to claim its type of car.

11. Tax consultant X has undertaken to give tax advice to companies A and B concerning the operations of a joint venture in which the latter are involved. Since the tax advice concerns the common venture of A and B and this advice is hardly divisible, A and B are to be considered as joint and several obligees when claiming performance from X.

## 5. Possible designation of an agent

In practice, plural obligees often designate an agent with the authority to deal with the obligor on behalf of all of them, within agreed limits. This seems to be especially frequent, for practical reasons, when the claims are separate. However, in that case, each obligee intends to keep full control of its own rights, often reserving the possibility to revoke the agent's authority at any time.

### Illustration

12. Banks A, B and C have joined in a syndicated loan agreement to lend USD 12,000,000 to company X. The claims are separate, USD 4,000,000 for each bank. However, A has been designated as agent of the consortium with authority to collect reimbursement of the full amount.

The initiative of designating an intermediary may come from an obligor who wants to exert some control over claims which could be separately brought by its numerous obligees.

### Illustration

13. Under the terms of issue of a bearer bond trustees are appointed to represent the interests of bondholders. The issuer covenants to make payments to each bondholder in accordance with the terms of issue and gives the trustee a parallel payment covenant. Upon the issuer's default the trustee may at its discretion enforce payment and must do so if so required by a given percentage in value of bondholders. Individual bondholders are precluded from taking action on default by the issuer, unless the trustee for the bondholders has failed to fulfil its obligation under the trust deed to take enforcement action. Each bondholder is a separate obligee. The purpose of the trust is simply to monitor performance by the issuer and co-ordinate enforcement in order to avoid precipitate action by an individual bondholder.

## ARTICLE 11.2.2

*(Effects of joint and several claims )*

**Full performance of an obligation in favour of one of the joint and several obligees discharges the obligor towards the other obligees.**

**COMMENT****1. Each obligee can claim full performance**

The main effect of joint and several claims has already been stated in the definition of Article 11.2.1(2). When claims are joint and several each obligee is entitled to claim full performance from the obligor.

**Illustration**

1. Co-owners A and B sell their hotel to buyer X for a price of EUR 5,000,000. Their shares of co-ownership are equal. The sales contract provides that the sellers' claims concerning payment of the price are joint and several. A may claim EUR 5,000,000 from X, subject to further allocation under Article 11.2.4.

**2. Obligor's choice**

This Article states two other major effects of joint and several claims.

First, if the obligor takes the initiative to spontaneously perform its obligation, it is entitled to render performance in favour of any of its obligees.

**Illustration**

2. The facts are the same as in Illustration 1. X takes the initiative of paying the price before being invited to do so by either of its obligees. X may validly pay to A or to B.

**3. Obligor's discharge**

Another main effect of joint and several claims is that the obligor who has rendered full performance in favour of one of the obligees is discharged towards the other obligees.

**Illustration**

3. The facts are the same as in Illustration 1. X has paid the whole price of EUR 5,000,000 to A. B, having difficulties to recover its share from A, requests payment of EUR 2,500,000 from X. Under Article 11.2.2(2), the claim will be rejected since full payment to A has discharged X towards the other obligee.

#### 4. Practical aspects

The right given to each of the joint or several obligees to claim full performance may call for some coordination to avoid duplication of initiatives and unnecessary costs. Either the obligees have agreed in advance on which of them will claim performance, or at least the obligee envisaging to take the initiative should consult with its co-obligees.

On the other hand, when the obligor takes the initiative its choice of obligee to which it will perform may be affected by the fact that another obligee is already requesting performance. Some prior consulting may then be appropriate. Furthermore, an obligee who has received payment should immediately inform the others that performance has been rendered.

These solutions could usefully be agreed in advance by all parties involved. Otherwise the requirements of good faith and fair dealing are always applicable (Article 1.7).

#### ARTICLE 11.2.3

*(Availability of defences against  
joint and several obligees)*

**(1) The obligor may assert against any of the joint and several obligees all the defences and rights of set-off that are personal to its relationship to that obligee or that it can assert against all the co-obligees, but may not assert defences and rights of set-off that are personal to its relationship to one or several of the other co-obligees.**

**(2) The provisions of Articles 11.1.5, 11.1.6, 11.1.7 and 11.1.8 apply, with appropriate adaptations, to joint and several claims.**

#### COMMENT

##### 1. Availability of defences

The defences which may entitle the obligor to refuse to perform do not necessarily exist against all obligees. Some of the defences may be personal to the obligor's relationship with one obligee only. These defences can be asserted only against the obligee concerned.

### Illustration

1. Grain producer X has agreed to supply a certain quantity of wheat seeds to companies A, B and C which are engaged in a common agricultural project in a developing country. The contract provides that A, B and C are joint and several obligees as concerns the deliveries. X discovers that the premises where it has to deliver the seeds are not equipped with appropriate facilities for convenient unloading, the availability of which only A has guaranteed. X may invoke this as a defence against A requiring delivery, but not against B and C which had not guaranteed that the premises for the delivery would be equipped with appropriate facilities.

The obligor may also assert defences that it has in common against all obligees.

### Illustration

2. The facts are the same as in Illustration 1. X finds out that the agricultural project involves child labour by A, B and C in violation of applicable mandatory rules. This is a common defence that X may assert against any one of the obligees claiming delivery of the wheat seeds.

## 2. Effects of certain defences

Section 1 of this Chapter contains particular rules about the effects of certain types of defence (see Articles 11.1.5, 11.1.6, 11.1.7 and 11.1.8) available to joint and several obligors. Paragraph (3) of this Article provides that these rules apply, with appropriate adaptations, to joint and several claims.

### a. *Performance and set-off (reference to Article 11.1.5)*

Article 11.1.5 provides that “*Performance or set-off by a joint and several obligor or set-off by the obligee against one joint and several obligor discharges the other obligors in relation to the obligee to the extent of the performance or set-off*”. Similarly, performance received by (or set-off exercised by) one of the joint and several obligees discharges the obligor towards the other obligees to the extent of the performance or set-off.

### Illustrations

3. Companies A, B and C have jointly and severally loaned EUR 300,000 to X. A receives full payment. If B or C still claims reimbursement, X may assert that it has fully performed to A.



4. The facts are the same as in Illustration 3, except that X can claim EUR 300,000 from A for the sale of office equipment. X exercises the right of set-off under Article 8.3. Its obligation under the loan agreement is extinguished not only vis-à-vis A but also vis-à-vis B and C.

b. *Release and settlement (reference to Article 11.1.6)*

Article 11.1.6 provides that “*Release of one joint and several obligor, or settlement with one joint and several obligor, discharges all the other obligors for the share of the released or settling obligor, unless the circumstances indicate otherwise*”. Similarly, release granted to the obligor by one of the obligees (or settlement with the obligor by one of the obligees) discharges the obligor towards the other obligees to the extent of the release or settlement.

Illustrations

5. Pamela, a famous race horse, has been sold by its co-owners A and B to buyer X. Concerning payment of the price, the contract provides that A and B are joint and several obligees. If A releases X from A’s share of X’s obligation, B’s claim against X is reduced by the amount of A’s share. A has no contributory recourse against B under Article 11.2.4 (see Article 11.1.6(2)).

6. The facts are the same as in Illustration 3, but A, whose share in the loan is EUR 100,000, settles with X, accepting a payment of EUR 60,000, i.e. an amount below its share. The joint and several claims of B and C against X are reduced by the full amount of A’s share, i.e. by EUR 100,000, and both remain X’s joint and several obligees for EUR 200,000. Settling obligee A has no recourse under Article 11.2.4 against B or C (see Article 11.1.6(2)).

As in Article 11.1.6, with appropriate adaptations, the reference to settlement concerns the special case where a separate settlement intervenes between the obligor and one of the joint and several obligees for the latter’s share. In this case the issue to be solved is that of the consequences of such a settlement for the other obligees’ claims.

In the more frequent situation where the settlement concerns all the joint and several claims, the consequences for the different obligees’ claims are determined by the terms of the settlement agreed by all parties and the contributory claims are adjusted accordingly.

*c. Expiration of limitation periods (reference to Article 11.1.7)*

Article 11.1.7 provides that the expiration of the limitation period of the obligee's rights against one joint and several obligor affects neither (a) the obligations to the obligee of the other joint and several obligors, nor (b) the rights of recourse between the joint and several obligors under Article 11.1.10. Similarly, the expiration of the limitation period of one of the obligees' rights against the obligor affects neither (a) the obligor's obligations towards the other joint and several obligees, nor (b) the rights of recourse between the joint and several obligees under Article 11.2.4.

**Illustration**

7. Obligor X has three joint and several obligees, A, B and C. A's claim against X is time-barred. This does not affect B and C's claims against X. If B or C receives performance from X, A can claim its share from the co-obligee having received payment.

Article 11.1.7 also provides that if the obligee initiates proceedings under Articles 10.5, 10.6 or 10.7 against one joint and several obligor, the running of the limitation period is suspended also against the other joint and several obligors. Similarly, if one of the obligees initiates proceedings against the obligor, the running of the limitation period is also suspended in favour of the other joint and several obligees.

*d. Effect of judgment (reference to Article 11.1.8)*

Article 11.1.8 provides that a decision by a court as to the liability to the obligee of one joint and several obligor affect neither (a) the obligations to the obligee of the other joint and several obligors, nor (b) the rights of recourse between the joint and several obligors under Article 11.1.10. Similarly, a decision by a court as to the obligor's liability towards one of the joint and several obligees affects neither (a) the obligor's obligations towards the other joint and several obligees, nor (b) the rights of recourse between the joint and several obligees under Article 11.2.4.

**Illustration**

8. Obligor X has three joint and several obligees, A, B and C. A, acting alone, sues X for performance. The judgement grants A only part of its claim. Such judgment does not affect the obligations of X towards B or C, nor the recourses between the co-obligees under Article 11.2.4.

However, Article 11.1.8(2) also provides that the other joint and several obligors may rely on such a decision, except if it were based on grounds personal to the obligor concerned. In this case, the rights of recourse between the joint and several obligors under Article 11.1.10 are affected accordingly. Similarly, the other joint and several obligees may rely on the decision if they find it in their interest, except if it was based on grounds personal to the obligee concerned.

#### Illustration

9. The facts are the same as in Illustration 8. This time, however, the judgment gives full satisfaction to A, including the awarding of additional damages. The other obligees may avail themselves of this favourable decision.

#### ARTICLE 11.2.4

*(Allocation between joint and several obligees)*

**(1) As among themselves, joint and several obligees are entitled to equal shares, unless the circumstances indicate otherwise.**

**(2) An obligee who has received more than its share must transfer the excess to the other obligees to the extent of their respective shares.**

#### COMMENT

##### 1. Presumption of equal shares

Joint and several obligees may each claim full performance of the whole obligation under Article 11.2.2. However, as among themselves, they are only entitled to their respective shares. These shares are presumed to be equal.

#### Illustration

1. Co-owners A and B have sold their factory for SFR 10,000,000, and they are joint and several obligees for the payment of the price. However, once the buyer has paid SFR 10,000,000, each co-owner will be entitled to receive its share in the final allocation. In principle, the shares are considered to be equal. Each co-owner should receive SFR 5,000,000.

However, the circumstances may indicate otherwise.

#### **Illustration**

2. The facts are the same as in Illustration 1, except that the shares of co-ownership of the factory were not equal, but 75% for A and 25% for B. This will indicate that A should receive SFR 7,500,000 and B SFR 2,500,000.

### **2. Transfer of excess received**

It will usually happen that the co-obligee claiming payment receives more than its share, as it is entitled to claim full performance under Article 11.2.2. When an obligee has received more than its share, it must transfer the excess to the other obligees to the extent of their respective shares.

#### **Illustration**

3. The facts are the same as in Illustration 1. A has been paid the full price of the factory, i.e. SFR 10,000,000, and its share of co-ownership was 50%. A must transfer SFR 5,000,000 to B.

Whether the claim of the other obligees to the sums in excess is a property right or merely a personal claim against the obligee who received more than its share is outside the scope of the Principles.

# **ANNEX** <sup>(\*)</sup>

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(\*) While recalling that the comments on the articles are to be seen as an integral part of the Principles, the text of the articles is reproduced separately in this annex for the convenience of the reader.



# UNIDROIT PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS 2010

## PREAMBLE

*(Purpose of the Principles)*

These Principles set forth general rules for international commercial contracts.

They shall be applied when the parties have agreed that their contract be governed by them.<sup>(\*)</sup>

They may be applied when the parties have agreed that their contract be governed by general principles of law, the *lex mercatoria* or the like.

They may be applied when the parties have not chosen any law to govern their contract.

They may be used to interpret or supplement international uniform law instruments.

They may be used to interpret or supplement domestic law.

They may serve as a model for national and international legislators.

## CHAPTER 1 — GENERAL PROVISIONS

### ARTICLE 1.1

*(Freedom of contract)*

The parties are free to enter into a contract and to determine its content.

### ARTICLE 1.2

*(No form required)*

Nothing in these Principles requires a contract, statement or any other act to be made in or evidenced by a particular form. It may be proved by any means, including witnesses.

### ARTICLE 1.3

*(Binding character of contract)*

A contract validly entered into is binding upon the parties. It can only be modified or terminated in accordance with its terms or by agreement or as otherwise provided in these Principles.

### ARTICLE 1.4

*(Mandatory rules)*

Nothing in these Principles shall restrict the application of mandatory rules, whether of national, international or supranational origin, which are applicable in accordance with the relevant rules of private international law.

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(\*) Parties wishing to provide that their agreement be governed by the Principles might use the following words, adding any desired exceptions or modifications:

**“This contract shall be governed by the UNIDROIT Principles (2010) [except as to Articles ...].”**

Parties wishing to provide in addition for the application of the law of a particular jurisdiction might use the following words:

**“This contract shall be governed by the UNIDROIT Principles (2010) [except as to Articles...], supplemented when necessary by the law of [jurisdiction X].”**

## **UNIDROIT Principles**

### **ARTICLE 1.5**

*(Exclusion or modification by the parties)*

The parties may exclude the application of these Principles or derogate from or vary the effect of any of their provisions, except as otherwise provided in the Principles.

### **ARTICLE 1.6**

*(Interpretation and supplementation of the Principles)*

(1) In the interpretation of these Principles, regard is to be had to their international character and to their purposes including the need to promote uniformity in their application.

(2) Issues within the scope of these Principles but not expressly settled by them are as far as possible to be settled in accordance with their underlying general principles.

### **ARTICLE 1.7**

*(Good faith and fair dealing)*

(1) Each party must act in accordance with good faith and fair dealing in international trade.

(2) The parties may not exclude or limit this duty.

### **ARTICLE 1.8**

*(Inconsistent behaviour)*

A party cannot act inconsistently with an understanding it has caused the other party to have and upon which that other party reasonably has acted in reliance to its detriment.

### **ARTICLE 1.9**

*(Usages and practices)*

(1) The parties are bound by any usage to which they have agreed and by any practices which they have established between themselves.

(2) The parties are bound by a usage that is widely known to and regularly observed in international trade by parties in the particular trade concerned except where the application of such a usage would be unreasonable.

### **ARTICLE 1.10**

*(Notice)*

(1) Where notice is required it may be given by any means appropriate to the circumstances.

(2) A notice is effective when it reaches the person to whom it is given.

(3) For the purpose of paragraph (2) a notice “reaches” a person when given to that person orally or delivered at that person’s place of business or mailing address.

(4) For the purpose of this Article “notice” includes a declaration, demand, request or any other communication of intention.

### **ARTICLE 1.11**

*(Definitions)*

In these Principles

- “court” includes an arbitral tribunal;
- where a party has more than one place of business the relevant “place of business” is that which has the closest relationship to the contract and its performance, having regard to the circumstances known to or contemplated by the parties at any time before or at the conclusion of the contract;
- “obligor” refers to the party who is to perform an obligation and “obligee” refers to the party who is entitled to performance of that obligation.



## **Annex**

– “writing” means any mode of communication that preserves a record of the information contained therein and is capable of being reproduced in tangible form.

### **ARTICLE 1.12**

*(Computation of time set by parties)*

- (1) Official holidays or non-business days occurring during a period set by parties for an act to be performed are included in calculating the period.
- (2) However, if the last day of the period is an official holiday or a non-business day at the place of business of the party to perform the act, the period is extended until the first business day which follows, unless the circumstances indicate otherwise.
- (3) The relevant time zone is that of the place of business of the party setting the time, unless the circumstances indicate otherwise.

## **CHAPTER 2 — FORMATION AND AUTHORITY OF AGENTS**

### **SECTION 1: FORMATION**

#### **ARTICLE 2.1.1**

*(Manner of formation)*

A contract may be concluded either by the acceptance of an offer or by conduct of the parties that is sufficient to show agreement.

#### **ARTICLE 2.1.2**

*(Definition of offer)*

A proposal for concluding a contract constitutes an offer if it is sufficiently definite and indicates the intention of the offeror to be bound in case of acceptance.

#### **ARTICLE 2.1.3**

*(Withdrawal of offer)*

- (1) An offer becomes effective when it reaches the offeree.
- (2) An offer, even if it is irrevocable, may be withdrawn if the withdrawal reaches the offeree before or at the same time as the offer.

#### **ARTICLE 2.1.4**

*(Revocation of offer)*

- (1) Until a contract is concluded an offer may be revoked if the revocation reaches the offeree before it has dispatched an acceptance.
- (2) However, an offer cannot be revoked
  - (a) if it indicates, whether by stating a fixed time for acceptance or otherwise, that it is irrevocable; or
  - (b) if it was reasonable for the offeree to rely on the offer as being irrevocable and the offeree has acted in reliance on the offer.

#### **ARTICLE 2.1.5**

*(Rejection of offer)*

An offer is terminated when a rejection reaches the offeror.

#### **ARTICLE 2.1.6**

*(Mode of acceptance)*

- (1) A statement made by or other conduct of the offeree indicating assent to an offer is an acceptance. Silence or inactivity does not in itself amount to acceptance.
- (2) An acceptance of an offer becomes effective when the indication of assent reaches the offeror.

## UNIDROIT Principles

(3) However, if, by virtue of the offer or as a result of practices which the parties have established between themselves or of usage, the offeree may indicate assent by performing an act without notice to the offeror, the acceptance is effective when the act is performed.

### ARTICLE 2.1.7

*(Time of acceptance)*

An offer must be accepted within the time the offeror has fixed or, if no time is fixed, within a reasonable time having regard to the circumstances, including the rapidity of the means of communication employed by the offeror. An oral offer must be accepted immediately unless the circumstances indicate otherwise.

### ARTICLE 2.1.8

*(Acceptance within a fixed period of time)*

A period of acceptance fixed by the offeror begins to run from the time that the offer is dispatched. A time indicated in the offer is deemed to be the time of dispatch unless the circumstances indicate otherwise.

### ARTICLE 2.1.9

*(Late acceptance. Delay in transmission)*

(1) A late acceptance is nevertheless effective as an acceptance if without undue delay the offeror so informs the offeree or gives notice to that effect.

(2) If a communication containing a late acceptance shows that it has been sent in such circumstances that if its transmission had been normal it would have reached the offeror in due time, the late acceptance is effective as an acceptance unless, without undue delay, the offeror informs the offeree that it considers the offer as having lapsed.

### ARTICLE 2.1.10

*(Withdrawal of acceptance)*

An acceptance may be withdrawn if the withdrawal reaches the offeror before or at the same time as the acceptance would have become effective.

### ARTICLE 2.1.11

*(Modified acceptance)*

(1) A reply to an offer which purports to be an acceptance but contains additions, limitations or other modifications is a rejection of the offer and constitutes a counter-offer.

(2) However, a reply to an offer which purports to be an acceptance but contains additional or different terms which do not materially alter the terms of the offer constitutes an acceptance, unless the offeror, without undue delay, objects to the discrepancy. If the offeror does not object, the terms of the contract are the terms of the offer with the modifications contained in the acceptance.

### ARTICLE 2.1.12

*(Writings in confirmation)*

If a writing which is sent within a reasonable time after the conclusion of the contract and which purports to be a confirmation of the contract contains additional or different terms, such terms become part of the contract, unless they materially alter the contract or the recipient, without undue delay, objects to the discrepancy.

## **Annex**

### **ARTICLE 2.1.13**

*(Conclusion of contract dependent on agreement on specific matters  
or in a particular form)*

Where in the course of negotiations one of the parties insists that the contract is not concluded until there is agreement on specific matters or in a particular form, no contract is concluded before agreement is reached on those matters or in that form.

### **ARTICLE 2.1.14**

*(Contract with terms deliberately left open)*

(1) If the parties intend to conclude a contract, the fact that they intentionally leave a term to be agreed upon in further negotiations or to be determined by a third person does not prevent a contract from coming into existence.

(2) The existence of the contract is not affected by the fact that subsequently

(a) the parties reach no agreement on the term; or

(b) the third person does not determine the term,

provided that there is an alternative means of rendering the term definite that is reasonable in the circumstances, having regard to the intention of the parties.

### **ARTICLE 2.1.15**

*(Negotiations in bad faith)*

(1) A party is free to negotiate and is not liable for failure to reach an agreement.

(2) However, a party who negotiates or breaks off negotiations in bad faith is liable for the losses caused to the other party.

(3) It is bad faith, in particular, for a party to enter into or continue negotiations when intending not to reach an agreement with the other party.

### **ARTICLE 2.1.16**

*(Duty of confidentiality)*

Where information is given as confidential by one party in the course of negotiations, the other party is under a duty not to disclose that information or to use it improperly for its own purposes, whether or not a contract is subsequently concluded. Where appropriate, the remedy for breach of that duty may include compensation based on the benefit received by the other party.

### **ARTICLE 2.1.17**

*(Merger clauses)*

A contract in writing which contains a clause indicating that the writing completely embodies the terms on which the parties have agreed cannot be contradicted or supplemented by evidence of prior statements or agreements. However, such statements or agreements may be used to interpret the writing.

### **ARTICLE 2.1.18**

*(Modification in a particular form)*

A contract in writing which contains a clause requiring any modification or termination by agreement to be in a particular form may not be otherwise modified or terminated. However, a party may be precluded by its conduct from asserting such a clause to the extent that the other party has reasonably acted in reliance on that conduct.

### **ARTICLE 2.1.19**

*(Contracting under standard terms)*

(1) Where one party or both parties use standard terms in concluding a contract, the general rules on formation apply, subject to Articles 2.1.20 - 2.1.22.

## UNIDROIT Principles

(2) Standard terms are provisions which are prepared in advance for general and repeated use by one party and which are actually used without negotiation with the other party.

### ARTICLE 2.1.20

*(Surprising terms)*

(1) No term contained in standard terms which is of such a character that the other party could not reasonably have expected it, is effective unless it has been expressly accepted by that party.

(2) In determining whether a term is of such a character regard shall be had to its content, language and presentation.

### ARTICLE 2.1.21

*(Conflict between standard terms and non-standard terms)*

In case of conflict between a standard term and a term which is not a standard term the latter prevails.

### ARTICLE 2.1.22

*(Battle of forms)*

Where both parties use standard terms and reach agreement except on those terms, a contract is concluded on the basis of the agreed terms and of any standard terms which are common in substance unless one party clearly indicates in advance, or later and without undue delay informs the other party, that it does not intend to be bound by such a contract.

## SECTION 2: AUTHORITY OF AGENTS

### ARTICLE 2.2.1

*(Scope of the Section)*

(1) This Section governs the authority of a person ("the agent") to affect the legal relations of another person ("the principal") by or with respect to a contract with a third party, whether the agent acts in its own name or in that of the principal.

(2) It governs only the relations between the principal or the agent on the one hand, and the third party on the other.

(3) It does not govern an agent's authority conferred by law or the authority of an agent appointed by a public or judicial authority.

### ARTICLE 2.2.2

*(Establishment and scope of the authority of the agent)*

(1) The principal's grant of authority to an agent may be express or implied.

(2) The agent has authority to perform all acts necessary in the circumstances to achieve the purposes for which the authority was granted.

### ARTICLE 2.2.3

*(Agency disclosed)*

(1) Where an agent acts within the scope of its authority and the third party knew or ought to have known that the agent was acting as an agent, the acts of the agent shall directly affect the legal relations between the principal and the third party and no legal relation is created between the agent and the third party.

(2) However, the acts of the agent shall affect only the relations between the agent and the third party, where the agent with the consent of the principal undertakes to become the party to the contract.

## **Annex**

### **ARTICLE 2.2.4**

#### *(Agency undisclosed)*

(1) Where an agent acts within the scope of its authority and the third party neither knew nor ought to have known that the agent was acting as an agent, the acts of the agent shall affect only the relations between the agent and the third party.

(2) However, where such an agent, when contracting with the third party on behalf of a business, represents itself to be the owner of that business, the third party, upon discovery of the real owner of the business, may exercise also against the latter the rights it has against the agent.

### **ARTICLE 2.2.5**

#### *(Agent acting without or exceeding its authority)*

(1) Where an agent acts without authority or exceeds its authority, its acts do not affect the legal relations between the principal and the third party.

(2) However, where the principal causes the third party reasonably to believe that the agent has authority to act on behalf of the principal and that the agent is acting within the scope of that authority, the principal may not invoke against the third party the lack of authority of the agent.

### **ARTICLE 2.2.6**

#### *(Liability of agent acting without or exceeding its authority)*

(1) An agent that acts without authority or exceeds its authority is, failing ratification by the principal, liable for damages that will place the third party in the same position as if the agent had acted with authority and not exceeded its authority.

(2) However, the agent is not liable if the third party knew or ought to have known that the agent had no authority or was exceeding its authority.

### **ARTICLE 2.2.7**

#### *(Conflict of interests)*

(1) If a contract concluded by an agent involves the agent in a conflict of interests with the principal of which the third party knew or ought to have known, the principal may avoid the contract. The right to avoid is subject to Articles 3.2.9 and 3.2.11 to 3.2.15.

(2) However, the principal may not avoid the contract

(a) if the principal had consented to, or knew or ought to have known of, the agent's involvement in the conflict of interests; or

(b) if the agent had disclosed the conflict of interests to the principal and the latter had not objected within a reasonable time.

### **ARTICLE 2.2.8**

#### *(Sub-agency)*

An agent has implied authority to appoint a sub-agent to perform acts which it is not reasonable to expect the agent to perform itself. The rules of this Section apply to the sub-agency.

### **ARTICLE 2.2.9**

#### *(Ratification)*

(1) An act by an agent that acts without authority or exceeds its authority may be ratified by the principal. On ratification the act produces the same effects as if it had initially been carried out with authority.

(2) The third party may by notice to the principal specify a reasonable period of time for ratification. If the principal does not ratify within that period of time it can no longer do so.

## UNIDROIT Principles

(3) If, at the time of the agent's act, the third party neither knew nor ought to have known of the lack of authority, it may, at any time before ratification, by notice to the principal indicate its refusal to become bound by a ratification.

### ARTICLE 2.2.10

*(Termination of authority)*

(1) Termination of authority is not effective in relation to the third party unless the third party knew or ought to have known of it.

(2) Notwithstanding the termination of its authority, an agent remains authorised to perform the acts that are necessary to prevent harm to the principal's interests.

## CHAPTER 3 — VALIDITY

### SECTION 1: GENERAL PROVISIONS

#### ARTICLE 3.1.1

*(Matters not covered)*

This Chapter does not deal with lack of capacity.

#### ARTICLE 3.1.2

*(Validity of mere agreement)*

A contract is concluded, modified or terminated by the mere agreement of the parties, without any further requirement.

#### ARTICLE 3.1.3

*(Initial impossibility)*

(1) The mere fact that at the time of the conclusion of the contract the performance of the obligation assumed was impossible does not affect the validity of the contract.

(2) The mere fact that at the time of the conclusion of the contract a party was not entitled to dispose of the assets to which the contract relates does not affect the validity of the contract.

#### ARTICLE 3.1.4

*(Mandatory character of the provisions)*

The provisions on fraud, threat, gross disparity and illegality contained in this Chapter are mandatory.

### SECTION 2: GROUNDS FOR AVOIDANCE

#### ARTICLE 3.2.1

*(Definition of mistake)*

Mistake is an erroneous assumption relating to facts or to law existing when the contract was concluded.

#### ARTICLE 3.2.2

*(Relevant mistake)*

(1) A party may only avoid the contract for mistake if, when the contract was concluded, the mistake was of such importance that a reasonable person in the same situation as the party in error would only have concluded the contract on materially different terms or would not have concluded it at all if the true state of affairs had been known, and

## **Annex**

(a) the other party made the same mistake, or caused the mistake, or knew or ought to have known of the mistake and it was contrary to reasonable commercial standards of fair dealing to leave the mistaken party in error; or

(b) the other party had not at the time of avoidance reasonably acted in reliance on the contract.

(2) However, a party may not avoid the contract if

(a) it was grossly negligent in committing the mistake; or

(b) the mistake relates to a matter in regard to which the risk of mistake was assumed or, having regard to the circumstances, should be borne by the mistaken party.

### **ARTICLE 3.2.3**

*(Error in expression or transmission)*

An error occurring in the expression or transmission of a declaration is considered to be a mistake of the person from whom the declaration emanated.

### **ARTICLE 3.2.4**

*(Remedies for non-performance)*

A party is not entitled to avoid the contract on the ground of mistake if the circumstances on which that party relies afford, or could have afforded, a remedy for non-performance.

### **ARTICLE 3.2.5**

*(Fraud)*

A party may avoid the contract when it has been led to conclude the contract by the other party's fraudulent representation, including language or practices, or fraudulent non-disclosure of circumstances which, according to reasonable commercial standards of fair dealing, the latter party should have disclosed.

### **ARTICLE 3.2.6**

*(Threat)*

A party may avoid the contract when it has been led to conclude the contract by the other party's unjustified threat which, having regard to the circumstances, is so imminent and serious as to leave the first party no reasonable alternative. In particular, a threat is unjustified if the act or omission with which a party has been threatened is wrongful in itself, or it is wrongful to use it as a means to obtain the conclusion of the contract.

### **ARTICLE 3.2.7**

*(Gross disparity)*

(1) A party may avoid the contract or an individual term of it if, at the time of the conclusion of the contract, the contract or term unjustifiably gave the other party an excessive advantage. Regard is to be had, among other factors, to

(a) the fact that the other party has taken unfair advantage of the first party's dependence, economic distress or urgent needs, or of its improvidence, ignorance, inexperience or lack of bargaining skill, and

(b) the nature and purpose of the contract.

(2) Upon the request of the party entitled to avoidance, a court may adapt the contract or term in order to make it accord with reasonable commercial standards of fair dealing.

(3) A court may also adapt the contract or term upon the request of the party receiving notice of avoidance, provided that that party informs the other party of its request promptly after receiving such notice and before the other party has reasonably acted in reliance on it. Article 3.2.10(2) applies accordingly.

## UNIDROIT Principles

### ARTICLE 3.2.8

#### *(Third persons)*

(1) Where fraud, threat, gross disparity or a party's mistake is imputable to, or is known or ought to be known by, a third person for whose acts the other party is responsible, the contract may be avoided under the same conditions as if the behaviour or knowledge had been that of the party itself.

(2) Where fraud, threat or gross disparity is imputable to a third person for whose acts the other party is not responsible, the contract may be avoided if that party knew or ought to have known of the fraud, threat or disparity, or has not at the time of avoidance reasonably acted in reliance on the contract.

### ARTICLE 3.2.9

#### *(Confirmation)*

If the party entitled to avoid the contract expressly or impliedly confirms the contract after the period of time for giving notice of avoidance has begun to run, avoidance of the contract is excluded.

### ARTICLE 3.2.10

#### *(Loss of right to avoid)*

(1) If a party is entitled to avoid the contract for mistake but the other party declares itself willing to perform or performs the contract as it was understood by the party entitled to avoidance, the contract is considered to have been concluded as the latter party understood it. The other party must make such a declaration or render such performance promptly after having been informed of the manner in which the party entitled to avoidance had understood the contract and before that party has reasonably acted in reliance on a notice of avoidance.

(2) After such a declaration or performance the right to avoidance is lost and any earlier notice of avoidance is ineffective.

### ARTICLE 3.2.11

#### *(Notice of avoidance)*

The right of a party to avoid the contract is exercised by notice to the other party.

### ARTICLE 3.2.12

#### *(Time limits)*

(1) Notice of avoidance shall be given within a reasonable time, having regard to the circumstances, after the avoiding party knew or could not have been unaware of the relevant facts or became capable of acting freely.

(2) Where an individual term of the contract may be avoided by a party under Article 3.2.7, the period of time for giving notice of avoidance begins to run when that term is asserted by the other party.

### ARTICLE 3.2.13

#### *(Partial avoidance)*

Where a ground of avoidance affects only individual terms of the contract, the effect of avoidance is limited to those terms unless, having regard to the circumstances, it is unreasonable to uphold the remaining contract.

### ARTICLE 3.2.14

#### *(Retroactive effect of avoidance)*

Avoidance takes effect retroactively.



## **Annex**

### **ARTICLE 3.2.15** *(Restitution)*

(1) On avoidance either party may claim restitution of whatever it has supplied under the contract, or the part of it avoided, provided that the party concurrently makes restitution of whatever it has received under the contract, or the part of it avoided.

(2) If restitution in kind is not possible or appropriate, an allowance has to be made in money whenever reasonable.

(3) The recipient of the performance does not have to make an allowance in money if the impossibility to make restitution in kind is attributable to the other party.

(4) Compensation may be claimed for expenses reasonably required to preserve or maintain the performance received.

### **ARTICLE 3.2.16** *(Damages)*

Irrespective of whether or not the contract has been avoided, the party who knew or ought to have known of the ground for avoidance is liable for damages so as to put the other party in the same position in which it would have been if it had not concluded the contract.

### **ARTICLE 3.2.17** *(Unilateral declarations)*

The provisions of this Chapter apply with appropriate adaptations to any communication of intention addressed by one party to the other.

## **SECTION 3: ILLEGALITY**

### **ARTICLE 3.3.1** *(Contracts infringing mandatory rules)*

(1) Where a contract infringes a mandatory rule, whether of national, international or supranational origin, applicable under Article 1.4 of these Principles, the effects of that infringement upon the contract are the effects, if any, expressly prescribed by that mandatory rule.

(2) Where the mandatory rule does not expressly prescribe the effects of an infringement upon a contract, the parties have the right to exercise such remedies under the contract as in the circumstances are reasonable.

- (3) In determining what is reasonable regard is to be had in particular to:
- (a) the purpose of the rule which has been infringed;
  - (b) the category of persons for whose protection the rule exists;
  - (c) any sanction that may be imposed under the rule infringed;
  - (d) the seriousness of the infringement;
  - (e) whether one or both parties knew or ought to have known of the infringement;
  - (f) whether the performance of the contract necessitates the infringement; and
  - (g) the parties' reasonable expectations.

### **ARTICLE 3.3.2** *(Restitution)*

(1) Where there has been performance under a contract infringing a mandatory rule under Article 3.3.1, restitution may be granted where this would be reasonable in the circumstances.

(2) In determining what is reasonable, regard is to be had, with the appropriate adaptations, to the criteria referred to in Article 3.3.1(3).

(3) If restitution is granted, the rules set out in Article 3.2.15 apply with appropriate adaptations.

# UNIDROIT Principles

## CHAPTER 4 — INTERPRETATION

### ARTICLE 4.1

*(Intention of the parties)*

(1) A contract shall be interpreted according to the common intention of the parties.

(2) If such an intention cannot be established, the contract shall be interpreted according to the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances.

### ARTICLE 4.2

*(Interpretation of statements and other conduct)*

(1) The statements and other conduct of a party shall be interpreted according to that party's intention if the other party knew or could not have been unaware of that intention.

(2) If the preceding paragraph is not applicable, such statements and other conduct shall be interpreted according to the meaning that a reasonable person of the same kind as the other party would give to it in the same circumstances.

### ARTICLE 4.3

*(Relevant circumstances)*

In applying Articles 4.1 and 4.2, regard shall be had to all the circumstances, including

- (a) preliminary negotiations between the parties;
- (b) practices which the parties have established between themselves;
- (c) the conduct of the parties subsequent to the conclusion of the contract;
- (d) the nature and purpose of the contract;
- (e) the meaning commonly given to terms and expressions in the trade concerned;
- (f) usages.

### ARTICLE 4.4

*(Reference to contract or statement as a whole)*

Terms and expressions shall be interpreted in the light of the whole contract or statement in which they appear.

### ARTICLE 4.5

*(All terms to be given effect)*

Contract terms shall be interpreted so as to give effect to all the terms rather than to deprive some of them of effect.

### ARTICLE 4.6

*(Contra proferentem rule)*

If contract terms supplied by one party are unclear, an interpretation against that party is preferred.

### ARTICLE 4.7

*(Linguistic discrepancies)*

Where a contract is drawn up in two or more language versions which are equally authoritative there is, in case of discrepancy between the versions, a preference for the interpretation according to a version in which the contract was originally drawn up.

## **Annex**

### **ARTICLE 4.8**

*(Supplying an omitted term)*

(1) Where the parties to a contract have not agreed with respect to a term which is important for a determination of their rights and duties, a term which is appropriate in the circumstances shall be supplied.

(2) In determining what is an appropriate term regard shall be had, among other factors, to

- (a) the intention of the parties;
- (b) the nature and purpose of the contract;
- (c) good faith and fair dealing;
- (d) reasonableness.

## **CHAPTER 5 — CONTENT AND THIRD PARTY RIGHTS**

### **SECTION 1: CONTENT**

#### **ARTICLE 5.1.1**

*(Express and implied obligations)*

The contractual obligations of the parties may be express or implied.

#### **ARTICLE 5.1.2**

*(Implied obligations)*

Implied obligations stem from

- (a) the nature and purpose of the contract;
- (b) practices established between the parties and usages;
- (c) good faith and fair dealing;
- (d) reasonableness.

#### **ARTICLE 5.1.3**

*(Co-operation between the parties)*

Each party shall cooperate with the other party when such co-operation may reasonably be expected for the performance of that party's obligations.

#### **ARTICLE 5.1.4**

*(Duty to achieve a specific result.  
Duty of best efforts)*

(1) To the extent that an obligation of a party involves a duty to achieve a specific result, that party is bound to achieve that result.

(2) To the extent that an obligation of a party involves a duty of best efforts in the performance of an activity, that party is bound to make such efforts as would be made by a reasonable person of the same kind in the same circumstances.

#### **ARTICLE 5.1.5**

*(Determination of kind of duty involved)*

In determining the extent to which an obligation of a party involves a duty of best efforts in the performance of an activity or a duty to achieve a specific result, regard shall be had, among other factors, to

- (a) the way in which the obligation is expressed in the contract;
- (b) the contractual price and other terms of the contract;
- (c) the degree of risk normally involved in achieving the expected result;
- (d) the ability of the other party to influence the performance of the obligation.

## **UNIDROIT Principles**

### **ARTICLE 5.1.6**

#### *(Determination of quality of performance)*

Where the quality of performance is neither fixed by, nor determinable from, the contract a party is bound to render a performance of a quality that is reasonable and not less than average in the circumstances.

### **ARTICLE 5.1.7**

#### *(Price determination)*

(1) Where a contract does not fix or make provision for determining the price, the parties are considered, in the absence of any indication to the contrary, to have made reference to the price generally charged at the time of the conclusion of the contract for such performance in comparable circumstances in the trade concerned or, if no such price is available, to a reasonable price.

(2) Where the price is to be determined by one party and that determination is manifestly unreasonable, a reasonable price shall be substituted notwithstanding any contract term to the contrary.

(3) Where the price is to be fixed by a third person, and that person cannot or will not do so, the price shall be a reasonable price.

(4) Where the price is to be fixed by reference to factors which do not exist or have ceased to exist or to be accessible, the nearest equivalent factor shall be treated as a substitute.

### **ARTICLE 5.1.8**

#### *(Contract for an indefinite period)*

A contract for an indefinite period may be ended by either party by giving notice a reasonable time in advance.

### **ARTICLE 5.1.9**

#### *(Release by agreement)*

(1) An obligee may release its right by agreement with the obligor.

(2) An offer to release a right gratuitously shall be deemed accepted if the obligor does not reject the offer without delay after having become aware of it.

## **SECTION 2: THIRD PARTY RIGHTS**

### **ARTICLE 5.2.1**

#### *(Contracts in favour of third parties)*

(1) The parties (the “promisor” and the “promisee”) may confer by express or implied agreement a right on a third party (the “beneficiary”).

(2) The existence and content of the beneficiary’s right against the promisor are determined by the agreement of the parties and are subject to any conditions or other limitations under the agreement.

### **ARTICLE 5.2.2**

#### *(Third party identifiable)*

The beneficiary must be identifiable with adequate certainty by the contract but need not be in existence at the time the contract is made.

### **ARTICLE 5.2.3**

#### *(Exclusion and limitation clauses)*

The conferment of rights in the beneficiary includes the right to invoke a clause in the contract which excludes or limits the liability of the beneficiary.

## **Annex**

### **ARTICLE 5.2.4** *(Defences)*

The promisor may assert against the beneficiary all defences which the promisor could assert against the promisee.

### **ARTICLE 5.2.5** *(Revocation)*

The parties may modify or revoke the rights conferred by the contract on the beneficiary until the beneficiary has accepted them or reasonably acted in reliance on them.

### **ARTICLE 5.2.6** *(Renunciation)*

The beneficiary may renounce a right conferred on it.

## **SECTION 3: CONDITIONS**

### **ARTICLE 5.3.1** *(Types of condition)*

A contract or a contractual obligation may be made conditional upon the occurrence of a future uncertain event, so that the contract or the contractual obligation only takes effect if the event occurs (suspensive condition) or comes to an end if the event occurs (resolutive condition).

### **ARTICLE 5.3.2** *(Effect of conditions)*

Unless the parties otherwise agree :

- (a) the relevant contract or contractual obligation takes effect upon fulfilment of a suspensive condition;
- (b) the relevant contract or contractual obligation comes to an end upon fulfilment of a resolutive condition.

### **ARTICLE 5.3.3** *(Interference with conditions)*

(1) If fulfilment of a condition is prevented by a party, contrary to the duty of good faith and fair dealing or the duty of co-operation, that party may not rely on the non-fulfilment of the condition.

(2) If fulfilment of a condition is brought about by a party, contrary to the duty of good faith and fair dealing or the duty of co-operation, that party may not rely on the fulfilment of the condition.

### **ARTICLE 5.3.4** *(Duty to preserve rights)*

Pending fulfilment of a condition, a party may not, contrary to the duty to act in accordance with good faith and fair dealing, act so as to prejudice the other party's rights in case of fulfilment of the condition.

### **ARTICLE 5.3.5** *(Restitution in case of fulfilment of a resolutive condition)*

(1) On fulfilment of a resolutive condition, the rules on restitution set out in Articles 7.3.6 and 7.3.7 apply with appropriate adaptations.

## UNIDROIT Principles

(2) If the parties have agreed that the resolutive condition is to operate retroactively, the rules on restitution set out in Article 3.2.15 apply with appropriate adaptations.

### CHAPTER 6 — PERFORMANCE

#### SECTION 1: PERFORMANCE IN GENERAL

##### ARTICLE 6.1.1

*(Time of performance)*

A party must perform its obligations:

- (a) if a time is fixed by or determinable from the contract, at that time;
- (b) if a period of time is fixed by or determinable from the contract, at any time within that period unless circumstances indicate that the other party is to choose a time;
- (c) in any other case, within a reasonable time after the conclusion of the contract.

##### ARTICLE 6.1.2

*(Performance at one time or in instalments)*

In cases under Article 6.1.1(b) or (c), a party must perform its obligations at one time if that performance can be rendered at one time and the circumstances do not indicate otherwise.

##### ARTICLE 6.1.3

*(Partial performance)*

(1) The obligee may reject an offer to perform in part at the time performance is due, whether or not such offer is coupled with an assurance as to the balance of the performance, unless the obligee has no legitimate interest in so doing.

(2) Additional expenses caused to the obligee by partial performance are to be borne by the obligor without prejudice to any other remedy.

##### ARTICLE 6.1.4

*(Order of performance)*

(1) To the extent that the performances of the parties can be rendered simultaneously, the parties are bound to render them simultaneously unless the circumstances indicate otherwise.

(2) To the extent that the performance of only one party requires a period of time, that party is bound to render its performance first, unless the circumstances indicate otherwise.

##### ARTICLE 6.1.5

*(Earlier performance)*

(1) The obligee may reject an earlier performance unless it has no legitimate interest in so doing.

(2) Acceptance by a party of an earlier performance does not affect the time for the performance of its own obligations if that time has been fixed irrespective of the performance of the other party's obligations.

(3) Additional expenses caused to the obligee by earlier performance are to be borne by the obligor, without prejudice to any other remedy.

##### ARTICLE 6.1.6

*(Place of performance)*

(1) If the place of performance is neither fixed by, nor determinable from, the contract, a party is to perform:

## **Annex**

- (a) a monetary obligation, at the obligee's place of business;
- (b) any other obligation, at its own place of business.
- (2) A party must bear any increase in the expenses incidental to performance which is caused by a change in its place of business subsequent to the conclusion of the contract.

### **ARTICLE 6.1.7**

*(Payment by cheque or other instrument)*

- (1) Payment may be made in any form used in the ordinary course of business at the place for payment.
- (2) However, an obligee who accepts, either by virtue of paragraph (1) or voluntarily, a cheque, any other order to pay or a promise to pay, is presumed to do so only on condition that it will be honoured.

### **ARTICLE 6.1.8**

*(Payment by funds transfer)*

- (1) Unless the obligee has indicated a particular account, payment may be made by a transfer to any of the financial institutions in which the obligee has made it known that it has an account.
- (2) In case of payment by a transfer the obligation of the obligor is discharged when the transfer to the obligee's financial institution becomes effective.

### **ARTICLE 6.1.9**

*(Currency of payment)*

- (1) If a monetary obligation is expressed in a currency other than that of the place for payment, it may be paid by the obligor in the currency of the place for payment unless
  - (a) that currency is not freely convertible; or
  - (b) the parties have agreed that payment should be made only in the currency in which the monetary obligation is expressed.
- (2) If it is impossible for the obligor to make payment in the currency in which the monetary obligation is expressed, the obligee may require payment in the currency of the place for payment, even in the case referred to in paragraph (1)(b).
- (3) Payment in the currency of the place for payment is to be made according to the applicable rate of exchange prevailing there when payment is due.
- (4) However, if the obligor has not paid at the time when payment is due, the obligee may require payment according to the applicable rate of exchange prevailing either when payment is due or at the time of actual payment.

### **ARTICLE 6.1.10**

*(Currency not expressed)*

Where a monetary obligation is not expressed in a particular currency, payment must be made in the currency of the place where payment is to be made.

### **ARTICLE 6.1.11**

*(Costs of performance)*

Each party shall bear the costs of performance of its obligations.

### **ARTICLE 6.1.12**

*(Imputation of payments)*

- (1) An obligor owing several monetary obligations to the same obligee may specify at the time of payment the debt to which it intends the payment to be applied.

## UNIDROIT Principles

However, the payment discharges first any expenses, then interest due and finally the principal.

(2) If the obligor makes no such specification, the obligee may, within a reasonable time after payment, declare to the obligor the obligation to which it imputes the payment, provided that the obligation is due and undisputed.

(3) In the absence of imputation under paragraphs (1) or (2), payment is imputed to that obligation which satisfies one of the following criteria in the order indicated:

- (a) an obligation which is due or which is the first to fall due;
- (b) the obligation for which the obligee has least security;
- (c) the obligation which is the most burdensome for the obligor;
- (d) the obligation which has arisen first.

If none of the preceding criteria applies, payment is imputed to all the obligations proportionally.

### ARTICLE 6.1.13

*(Imputation of non-monetary obligations)*

Article 6.1.12 applies with appropriate adaptations to the imputation of performance of non-monetary obligations.

### ARTICLE 6.1.14

*(Application for public permission)*

Where the law of a State requires a public permission affecting the validity of the contract or its performance and neither that law nor the circumstances indicate otherwise

(a) if only one party has its place of business in that State, that party shall take the measures necessary to obtain the permission;

(b) in any other case the party whose performance requires permission shall take the necessary measures.

### ARTICLE 6.1.15

*(Procedure in applying for permission)*

(1) The party required to take the measures necessary to obtain the permission shall do so without undue delay and shall bear any expenses incurred.

(2) That party shall whenever appropriate give the other party notice of the grant or refusal of such permission without undue delay.

### ARTICLE 6.1.16

*(Permission neither granted nor refused)*

(1) If, notwithstanding the fact that the party responsible has taken all measures required, permission is neither granted nor refused within an agreed period or, where no period has been agreed, within a reasonable time from the conclusion of the contract, either party is entitled to terminate the contract.

(2) Where the permission affects some terms only, paragraph (1) does not apply if, having regard to the circumstances, it is reasonable to uphold the remaining contract even if the permission is refused.

### ARTICLE 6.1.17

*(Permission refused)*

(1) The refusal of a permission affecting the validity of the contract renders the contract void. If the refusal affects the validity of some terms only, only such terms are void if, having regard to the circumstances, it is reasonable to uphold the remaining contract.

(2) Where the refusal of a permission renders the performance of the contract impossible in whole or in part, the rules on non-performance apply.



## **Annex**

### **SECTION 2: HARDSHIP**

#### **ARTICLE 6.2.1**

*(Contract to be observed)*

Where the performance of a contract becomes more onerous for one of the parties, that party is nevertheless bound to perform its obligations subject to the following provisions on hardship.

#### **ARTICLE 6.2.2**

*(Definition of hardship)*

There is hardship where the occurrence of events fundamentally alters the equilibrium of the contract either because the cost of a party's performance has increased or because the value of the performance a party receives has diminished, and

- (a) the events occur or become known to the disadvantaged party after the conclusion of the contract;
- (b) the events could not reasonably have been taken into account by the disadvantaged party at the time of the conclusion of the contract;
- (c) the events are beyond the control of the disadvantaged party; and
- (d) the risk of the events was not assumed by the disadvantaged party.

#### **ARTICLE 6.2.3**

*(Effects of hardship)*

(1) In case of hardship the disadvantaged party is entitled to request renegotiations. The request shall be made without undue delay and shall indicate the grounds on which it is based.

(2) The request for renegotiation does not in itself entitle the disadvantaged party to withhold performance.

(3) Upon failure to reach agreement within a reasonable time either party may resort to the court.

- (4) If the court finds hardship it may, if reasonable,
  - (a) terminate the contract at a date and on terms to be fixed, or
  - (b) adapt the contract with a view to restoring its equilibrium.

## **CHAPTER 7 — NON-PERFORMANCE**

### **SECTION 1: NON-PERFORMANCE IN GENERAL**

#### **ARTICLE 7.1.1**

*(Non-performance defined)*

Non-performance is failure by a party to perform any of its obligations under the contract, including defective performance or late performance.

#### **ARTICLE 7.1.2**

*(Interference by the other party)*

A party may not rely on the non-performance of the other party to the extent that such non-performance was caused by the first party's act or omission or by another event for which the first party bears the risk.

#### **ARTICLE 7.1.3**

*(Withholding performance)*

(1) Where the parties are to perform simultaneously, either party may withhold performance until the other party tenders its performance.

## UNIDROIT Principles

(2) Where the parties are to perform consecutively, the party that is to perform later may withhold its performance until the first party has performed.

### ARTICLE 7.1.4

*(Cure by non-performing party)*

(1) The non-performing party may, at its own expense, cure any non-performance, provided that

(a) without undue delay, it gives notice indicating the proposed manner and timing of the cure;

(b) cure is appropriate in the circumstances;

(c) the aggrieved party has no legitimate interest in refusing cure; and

(d) cure is effected promptly.

(2) The right to cure is not precluded by notice of termination.

(3) Upon effective notice of cure, rights of the aggrieved party that are inconsistent with the non-performing party's performance are suspended until the time for cure has expired.

(4) The aggrieved party may withhold performance pending cure.

(5) Notwithstanding cure, the aggrieved party retains the right to claim damages for delay as well as for any harm caused or not prevented by the cure.

### ARTICLE 7.1.5

*(Additional period for performance)*

(1) In a case of non-performance the aggrieved party may by notice to the other party allow an additional period of time for performance.

(2) During the additional period the aggrieved party may withhold performance of its own reciprocal obligations and may claim damages but may not resort to any other remedy. If it receives notice from the other party that the latter will not perform within that period, or if upon expiry of that period due performance has not been made, the aggrieved party may resort to any of the remedies that may be available under this Chapter.

(3) Where in a case of delay in performance which is not fundamental the aggrieved party has given notice allowing an additional period of time of reasonable length, it may terminate the contract at the end of that period. If the additional period allowed is not of reasonable length it shall be extended to a reasonable length. The aggrieved party may in its notice provide that if the other party fails to perform within the period allowed by the notice the contract shall automatically terminate.

(4) Paragraph (3) does not apply where the obligation which has not been performed is only a minor part of the contractual obligation of the non-performing party.

### ARTICLE 7.1.6

*(Exemption clauses)*

A clause which limits or excludes one party's liability for non-performance or which permits one party to render performance substantially different from what the other party reasonably expected may not be invoked if it would be grossly unfair to do so, having regard to the purpose of the contract.

### ARTICLE 7.1.7

*(Force majeure)*

(1) Non-performance by a party is excused if that party proves that the non-performance was due to an impediment beyond its control and that it could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.

## **Annex**

(2) When the impediment is only temporary, the excuse shall have effect for such period as is reasonable having regard to the effect of the impediment on the performance of the contract.

(3) The party who fails to perform must give notice to the other party of the impediment and its effect on its ability to perform. If the notice is not received by the other party within a reasonable time after the party who fails to perform knew or ought to have known of the impediment, it is liable for damages resulting from such non-receipt.

(4) Nothing in this Article prevents a party from exercising a right to terminate the contract or to withhold performance or request interest on money due.

### **SECTION 2: RIGHT TO PERFORMANCE**

#### **ARTICLE 7.2.1**

*(Performance of monetary obligation)*

Where a party who is obliged to pay money does not do so, the other party may require payment.

#### **ARTICLE 7.2.2**

*(Performance of non-monetary obligation)*

Where a party who owes an obligation other than one to pay money does not perform, the other party may require performance, unless

- (a) performance is impossible in law or in fact;
- (b) performance or, where relevant, enforcement is unreasonably burdensome or expensive;
- (c) the party entitled to performance may reasonably obtain performance from another source;
- (d) performance is of an exclusively personal character; or
- (e) the party entitled to performance does not require performance within a reasonable time after it has, or ought to have, become aware of the non-performance.

#### **ARTICLE 7.2.3**

*(Repair and replacement of defective performance)*

The right to performance includes in appropriate cases the right to require repair, replacement, or other cure of defective performance. The provisions of Articles 7.2.1 and 7.2.2 apply accordingly.

#### **ARTICLE 7.2.4**

*(Judicial penalty)*

(1) Where the court orders a party to perform, it may also direct that this party pay a penalty if it does not comply with the order.

(2) The penalty shall be paid to the aggrieved party unless mandatory provisions of the law of the forum provide otherwise. Payment of the penalty to the aggrieved party does not exclude any claim for damages.

#### **ARTICLE 7.2.5**

*(Change of remedy)*

(1) An aggrieved party who has required performance of a non-monetary obligation and who has not received performance within a period fixed or otherwise within a reasonable period of time may invoke any other remedy.

(2) Where the decision of a court for performance of a non-monetary obligation cannot be enforced, the aggrieved party may invoke any other remedy.

# UNIDROIT Principles

## SECTION 3: TERMINATION

### ARTICLE 7.3.1

#### *(Right to terminate the contract)*

- (1) A party may terminate the contract where the failure of the other party to perform an obligation under the contract amounts to a fundamental non-performance.
- (2) In determining whether a failure to perform an obligation amounts to a fundamental non-performance regard shall be had, in particular, to whether
  - (a) the non-performance substantially deprives the aggrieved party of what it was entitled to expect under the contract unless the other party did not foresee and could not reasonably have foreseen such result;
  - (b) strict compliance with the obligation which has not been performed is of essence under the contract;
  - (c) the non-performance is intentional or reckless;
  - (d) the non-performance gives the aggrieved party reason to believe that it cannot rely on the other party's future performance;
  - (e) the non-performing party will suffer disproportionate loss as a result of the preparation or performance if the contract is terminated.
- (3) In the case of delay the aggrieved party may also terminate the contract if the other party fails to perform before the time allowed it under Article 7.1.5 has expired.

### ARTICLE 7.3.2

#### *(Notice of termination)*

- (1) The right of a party to terminate the contract is exercised by notice to the other party.
- (2) If performance has been offered late or otherwise does not conform to the contract the aggrieved party will lose its right to terminate the contract unless it gives notice to the other party within a reasonable time after it has or ought to have become aware of the offer or of the non-conforming performance.

### ARTICLE 7.3.3

#### *(Anticipatory non-performance)*

Where prior to the date for performance by one of the parties it is clear that there will be a fundamental non-performance by that party, the other party may terminate the contract.

### ARTICLE 7.3.4

#### *(Adequate assurance of due performance)*

A party who reasonably believes that there will be a fundamental non-performance by the other party may demand adequate assurance of due performance and may meanwhile withhold its own performance. Where this assurance is not provided within a reasonable time the party demanding it may terminate the contract.

### ARTICLE 7.3.5

#### *(Effects of termination in general)*

- (1) Termination of the contract releases both parties from their obligation to effect and to receive future performance.
- (2) Termination does not preclude a claim for damages for non-performance.
- (3) Termination does not affect any provision in the contract for the settlement of disputes or any other term of the contract which is to operate even after termination.

## **Annex**

### **ARTICLE 7.3.6**

*(Restitution with respect to contracts to be performed at one time)*

(1) On termination of a contract to be performed at one time either party may claim restitution of whatever it has supplied under the contract, provided that such party concurrently makes restitution of whatever it has received under the contract.

(2) If restitution in kind is not possible or appropriate, an allowance has to be made in money whenever reasonable.

(3) The recipient of the performance does not have to make an allowance in money if the impossibility to make restitution in kind is attributable to the other party.

(4) Compensation may be claimed for expenses reasonably required to preserve or maintain the performance received.

### **ARTICLE 7.3.7**

*(Restitution with respect to contracts to be performed over a period of time)*

(1) On termination of a contract to be performed over a period of time restitution can only be claimed for the period after termination has taken effect, provided the contract is divisible.

(2) As far as restitution has to be made, the provisions of Article 7.3.6 apply.

## **SECTION 4: DAMAGES**

### **ARTICLE 7.4.1**

*(Right to damages)*

Any non-performance gives the aggrieved party a right to damages either exclusively or in conjunction with any other remedies except where the non-performance is excused under these Principles.

### **ARTICLE 7.4.2**

*(Full compensation)*

(1) The aggrieved party is entitled to full compensation for harm sustained as a result of the non-performance. Such harm includes both any loss which it suffered and any gain of which it was deprived, taking into account any gain to the aggrieved party resulting from its avoidance of cost or harm.

(2) Such harm may be non-pecuniary and includes, for instance, physical suffering or emotional distress.

### **ARTICLE 7.4.3**

*(Certainty of harm)*

(1) Compensation is due only for harm, including future harm, that is established with a reasonable degree of certainty.

(2) Compensation may be due for the loss of a chance in proportion to the probability of its occurrence.

(3) Where the amount of damages cannot be established with a sufficient degree of certainty, the assessment is at the discretion of the court.

### **ARTICLE 7.4.4**

*(Foreseeability of harm)*

The non-performing party is liable only for harm which it foresaw or could reasonably have foreseen at the time of the conclusion of the contract as being likely to result from its non-performance.

## UNIDROIT Principles

### ARTICLE 7.4.5

*(Proof of harm in case of replacement transaction)*

Where the aggrieved party has terminated the contract and has made a replacement transaction within a reasonable time and in a reasonable manner it may recover the difference between the contract price and the price of the replacement transaction as well as damages for any further harm.

### ARTICLE 7.4.6

*(Proof of harm by current price)*

(1) Where the aggrieved party has terminated the contract and has not made a replacement transaction but there is a current price for the performance contracted for, it may recover the difference between the contract price and the price current at the time the contract is terminated as well as damages for any further harm.

(2) Current price is the price generally charged for goods delivered or services rendered in comparable circumstances at the place where the contract should have been performed or, if there is no current price at that place, the current price at such other place that appears reasonable to take as a reference.

### ARTICLE 7.4.7

*(Harm due in part to aggrieved party)*

Where the harm is due in part to an act or omission of the aggrieved party or to another event for which that party bears the risk, the amount of damages shall be reduced to the extent that these factors have contributed to the harm, having regard to the conduct of each of the parties.

### ARTICLE 7.4.8

*(Mitigation of harm)*

(1) The non-performing party is not liable for harm suffered by the aggrieved party to the extent that the harm could have been reduced by the latter party's taking reasonable steps.

(2) The aggrieved party is entitled to recover any expenses reasonably incurred in attempting to reduce the harm.

### ARTICLE 7.4.9

*(Interest for failure to pay money)*

(1) If a party does not pay a sum of money when it falls due the aggrieved party is entitled to interest upon that sum from the time when payment is due to the time of payment whether or not the non-payment is excused.

(2) The rate of interest shall be the average bank short-term lending rate to prime borrowers prevailing for the currency of payment at the place for payment, or where no such rate exists at that place, then the same rate in the State of the currency of payment. In the absence of such a rate at either place the rate of interest shall be the appropriate rate fixed by the law of the State of the currency of payment.

(3) The aggrieved party is entitled to additional damages if the non-payment caused it a greater harm.

### ARTICLE 7.4.10

*(Interest on damages)*

Unless otherwise agreed, interest on damages for non-performance of non-monetary obligations accrues as from the time of non-performance.

## **Annex**

### **ARTICLE 7.4.11**

*(Manner of monetary redress)*

- (1) Damages are to be paid in a lump sum. However, they may be payable in instalments where the nature of the harm makes this appropriate.
- (2) Damages to be paid in instalments may be indexed.

### **ARTICLE 7.4.12**

*(Currency in which to assess damages)*

Damages are to be assessed either in the currency in which the monetary obligation was expressed or in the currency in which the harm was suffered, whichever is more appropriate.

### **ARTICLE 7.4.13**

*(Agreed payment for non-performance)*

- (1) Where the contract provides that a party who does not perform is to pay a specified sum to the aggrieved party for such non-performance, the aggrieved party is entitled to that sum irrespective of its actual harm.
- (2) However, notwithstanding any agreement to the contrary the specified sum may be reduced to a reasonable amount where it is grossly excessive in relation to the harm resulting from the non-performance and to the other circumstances.

## **CHAPTER 8 — SET-OFF**

### **ARTICLE 8.1**

*(Conditions of set-off)*

- (1) Where two parties owe each other money or other performances of the same kind, either of them (“the first party”) may set off its obligation against that of its obligee (“the other party”) if at the time of set-off,
  - (a) the first party is entitled to perform its obligation;
  - (b) the other party’s obligation is ascertained as to its existence and amount and performance is due.
- (2) If the obligations of both parties arise from the same contract, the first party may also set off its obligation against an obligation of the other party which is not ascertained as to its existence or to its amount.

### **ARTICLE 8.2**

*(Foreign currency set-off)*

Where the obligations are to pay money in different currencies, the right of set-off may be exercised, provided that both currencies are freely convertible and the parties have not agreed that the first party shall pay only in a specified currency.

### **ARTICLE 8.3**

*(Set-off by notice)*

The right of set-off is exercised by notice to the other party.

### **ARTICLE 8.4**

*(Content of notice)*

- (1) The notice must specify the obligations to which it relates.
- (2) If the notice does not specify the obligation against which set-off is exercised, the other party may, within a reasonable time, declare to the first party the obligation to which set-off relates. If no such declaration is made, the set-off will relate to all the obligations proportionally.

## UNIDROIT Principles

### ARTICLE 8.5

*(Effect of set-off)*

- (1) Set-off discharges the obligations.
- (2) If obligations differ in amount, set-off discharges the obligations up to the amount of the lesser obligation.
- (3) Set-off takes effect as from the time of notice.

## CHAPTER 9 — ASSIGNMENT OF RIGHTS, TRANSFER OF OBLIGATIONS, ASSIGNMENT OF CONTRACTS

### SECTION 1: ASSIGNMENT OF RIGHTS

#### ARTICLE 9.1.1

*(Definitions)*

“Assignment of a right” means the transfer by agreement from one person (the “assignor”) to another person (the “assignee”), including transfer by way of security, of the assignor’s right to payment of a monetary sum or other performance from a third person (“the obligor”).

#### ARTICLE 9.1.2

*(Exclusions)*

This Section does not apply to transfers made under the special rules governing the transfers:

- (a) of instruments such as negotiable instruments, documents of title or financial instruments, or
- (b) of rights in the course of transferring a business.

#### ARTICLE 9.1.3

*(Assignability of non-monetary rights)*

A right to non-monetary performance may be assigned only if the assignment does not render the obligation significantly more burdensome.

#### ARTICLE 9.1.4

*(Partial assignment)*

- (1) A right to the payment of a monetary sum may be assigned partially.
- (2) A right to other performance may be assigned partially only if it is divisible, and the assignment does not render the obligation significantly more burdensome.

#### ARTICLE 9.1.5

*(Future rights)*

A future right is deemed to be transferred at the time of the agreement, provided the right, when it comes into existence, can be identified as the right to which the assignment relates.

#### ARTICLE 9.1.6

*(Rights assigned without individual specification)*

A number of rights may be assigned without individual specification, provided such rights can be identified as rights to which the assignment relates at the time of the assignment or when they come into existence.



## **Annex**

### **ARTICLE 9.1.7**

*(Agreement between assignor and assignee sufficient)*

(1) A right is assigned by mere agreement between the assignor and the assignee, without notice to the obligor.

(2) The consent of the obligor is not required unless the obligation in the circumstances is of an essentially personal character.

### **ARTICLE 9.1.8**

*(Obligor's additional costs)*

The obligor has a right to be compensated by the assignor or the assignee for any additional costs caused by the assignment.

### **ARTICLE 9.1.9**

*(Non-assignment clauses)*

(1) The assignment of a right to the payment of a monetary sum is effective notwithstanding an agreement between the assignor and the obligor limiting or prohibiting such an assignment. However, the assignor may be liable to the obligor for breach of contract.

(2) The assignment of a right to other performance is ineffective if it is contrary to an agreement between the assignor and the obligor limiting or prohibiting the assignment. Nevertheless, the assignment is effective if the assignee, at the time of the assignment, neither knew nor ought to have known of the agreement. The assignor may then be liable to the obligor for breach of contract.

### **ARTICLE 9.1.10**

*(Notice to the obligor)*

(1) Until the obligor receives a notice of the assignment from either the assignor or the assignee, it is discharged by paying the assignor.

(2) After the obligor receives such a notice, it is discharged only by paying the assignee.

### **ARTICLE 9.1.11**

*(Successive assignments)*

If the same right has been assigned by the same assignor to two or more successive assignees, the obligor is discharged by paying according to the order in which the notices were received.

### **ARTICLE 9.1.12**

*(Adequate proof of assignment)*

(1) If notice of the assignment is given by the assignee, the obligor may request the assignee to provide within a reasonable time adequate proof that the assignment has been made.

(2) Until adequate proof is provided, the obligor may withhold payment.

(3) Unless adequate proof is provided, notice is not effective.

(4) Adequate proof includes, but is not limited to, any writing emanating from the assignor and indicating that the assignment has taken place.

### **ARTICLE 9.1.13**

*(Defences and rights of set-off)*

(1) The obligor may assert against the assignee all defences that the obligor could assert against the assignor.

(2) The obligor may exercise against the assignee any right of set-off available to the obligor against the assignor up to the time notice of assignment was received.

## UNIDROIT Principles

### ARTICLE 9.1.14

*(Rights related to the right assigned)*

The assignment of a right transfers to the assignee:

- (a) all the assignor's rights to payment or other performance under the contract in respect of the right assigned, and
- (b) all rights securing performance of the right assigned.

### ARTICLE 9.1.15

*(Undertakings of the assignor)*

The assignor undertakes towards the assignee, except as otherwise disclosed to the assignee, that:

- (a) the assigned right exists at the time of the assignment, unless the right is a future right;
- (b) the assignor is entitled to assign the right;
- (c) the right has not been previously assigned to another assignee, and it is free from any right or claim from a third party;
- (d) the obligor does not have any defences;
- (e) neither the obligor nor the assignor has given notice of set-off concerning the assigned right and will not give any such notice;
- (f) the assignor will reimburse the assignee for any payment received from the obligor before notice of the assignment was given.

## SECTION 2: TRANSFER OF OBLIGATIONS

### ARTICLE 9.2.1

*(Modes of transfer)*

An obligation to pay money or render other performance may be transferred from one person (the "original obligor") to another person (the "new obligor") either

- (a) by an agreement between the original obligor and the new obligor subject to Article 9.2.3, or
- (b) by an agreement between the obligee and the new obligor, by which the new obligor assumes the obligation.

### ARTICLE 9.2.2

*(Exclusion)*

This Section does not apply to transfers of obligations made under the special rules governing transfers of obligations in the course of transferring a business.

### ARTICLE 9.2.3

*(Requirement of obligee's consent to transfer)*

The transfer of an obligation by an agreement between the original obligor and the new obligor requires the consent of the obligee.

### ARTICLE 9.2.4

*(Advance consent of obligee)*

- (1) The obligee may give its consent in advance.
- (2) If the obligee has given its consent in advance, the transfer of the obligation becomes effective when a notice of the transfer is given to the obligee or when the obligee acknowledges it.

### ARTICLE 9.2.5

*(Discharge of original obligor)*

- (1) The obligee may discharge the original obligor.

## **Annex**

(2) The obligee may also retain the original obligor as an obligor in case the new obligor does not perform properly.

(3) Otherwise the original obligor and the new obligor are jointly and severally liable.

### **ARTICLE 9.2.6**

#### *(Third party performance)*

(1) Without the obligee's consent, the obligor may contract with another person that this person will perform the obligation in place of the obligor, unless the obligation in the circumstances has an essentially personal character.

(2) The obligee retains its claim against the obligor.

### **ARTICLE 9.2.7**

#### *(Defences and rights of set-off)*

(1) The new obligor may assert against the obligee all defences which the original obligor could assert against the obligee.

(2) The new obligor may not exercise against the obligee any right of set-off available to the original obligor against the obligee.

### **ARTICLE 9.2.8**

#### *(Rights related to the obligation transferred)*

(1) The obligee may assert against the new obligor all its rights to payment or other performance under the contract in respect of the obligation transferred.

(2) If the original obligor is discharged under Article 9.2.5(1), a security granted by any person other than the new obligor for the performance of the obligation is discharged, unless that other person agrees that it should continue to be available to the obligee.

(3) Discharge of the original obligor also extends to any security of the original obligor given to the obligee for the performance of the obligation, unless the security is over an asset which is transferred as part of a transaction between the original obligor and the new obligor.

## **SECTION 3: ASSIGNMENT OF CONTRACTS**

### **ARTICLE 9.3.1**

#### *(Definitions)*

"Assignment of a contract" means the transfer by agreement from one person (the "assignor") to another person (the "assignee") of the assignor's rights and obligations arising out of a contract with another person (the "other party").

### **ARTICLE 9.3.2**

#### *(Exclusion)*

This Section does not apply to the assignment of contracts made under the special rules governing transfers of contracts in the course of transferring a business.

### **ARTICLE 9.3.3**

#### *(Requirement of consent of the other party)*

The assignment of a contract requires the consent of the other party.

### **ARTICLE 9.3.4**

#### *(Advance consent of the other party)*

(1) The other party may give its consent in advance.

## UNIDROIT Principles

(2) If the other party has given its consent in advance, the assignment of the contract becomes effective when a notice of the assignment is given to the other party or when the other party acknowledges it.

### ARTICLE 9.3.5

*(Discharge of the assignor)*

- (1) The other party may discharge the assignor.
- (2) The other party may also retain the assignor as an obligor in case the assignee does not perform properly.
- (3) Otherwise the assignor and the assignee are jointly and severally liable.

### ARTICLE 9.3.6

*(Defences and rights of set-off)*

- (1) To the extent that the assignment of a contract involves an assignment of rights, Article 9.1.13 applies accordingly.
- (2) To the extent that the assignment of a contract involves a transfer of obligations, Article 9.2.7 applies accordingly.

### ARTICLE 9.3.7

*(Rights transferred with the contract)*

- (1) To the extent that the assignment of a contract involves an assignment of rights, Article 9.1.14 applies accordingly.
- (2) To the extent that the assignment of a contract involves a transfer of obligations, Article 9.2.8 applies accordingly.

## CHAPTER 10 — LIMITATION PERIODS

### ARTICLE 10.1

*(Scope of the Chapter)*

- (1) The exercise of rights governed by the Principles is barred by the expiration of a period of time, referred to as “limitation period”, according to the rules of this Chapter.
- (2) This Chapter does not govern the time within which one party is required under the Principles, as a condition for the acquisition or exercise of its right, to give notice to the other party or to perform any act other than the institution of legal proceedings.

### ARTICLE 10.2

*(Limitation periods)*

- (1) The general limitation period is three years beginning on the day after the day the obligee knows or ought to know the facts as a result of which the obligee’s right can be exercised.
- (2) In any event, the maximum limitation period is ten years beginning on the day after the day the right can be exercised.

### ARTICLE 10.3

*(Modification of limitation periods by the parties)*

- (1) The parties may modify the limitation periods.
- (2) However they may not
  - (a) shorten the general limitation period to less than one year;
  - (b) shorten the maximum limitation period to less than four years;
  - (c) extend the maximum limitation period to more than fifteen years.

## **Annex**

### **ARTICLE 10.4**

*(New limitation period by acknowledgement)*

(1) Where the obligor before the expiration of the general limitation period acknowledges the right of the obligee, a new general limitation period begins on the day after the day of the acknowledgement.

(2) The maximum limitation period does not begin to run again, but may be exceeded by the beginning of a new general limitation period under Article 10.2(1).

### **ARTICLE 10.5**

*(Suspension by judicial proceedings)*

(1) The running of the limitation period is suspended

(a) when the obligee performs any act, by commencing judicial proceedings or in judicial proceedings already instituted, that is recognised by the law of the court as asserting the obligee's right against the obligor;

(b) in the case of the obligor's insolvency when the obligee has asserted its rights in the insolvency proceedings; or

(c) in the case of proceedings for dissolution of the entity which is the obligor when the obligee has asserted its rights in the dissolution proceedings.

(2) Suspension lasts until a final decision has been issued or until the proceedings have been otherwise terminated.

### **ARTICLE 10.6**

*(Suspension by arbitral proceedings)*

(1) The running of the limitation period is suspended when the obligee performs any act, by commencing arbitral proceedings or in arbitral proceedings already instituted, that is recognised by the law of the arbitral tribunal as asserting the obligee's right against the obligor. In the absence of regulations for arbitral proceedings or provisions determining the exact date of the commencement of arbitral proceedings, the proceedings are deemed to commence on the date on which a request that the right in dispute should be adjudicated reaches the obligor.

(2) Suspension lasts until a binding decision has been issued or until the proceedings have been otherwise terminated.

### **ARTICLE 10.7**

*(Alternative dispute resolution)*

The provisions of Articles 10.5 and 10.6 apply with appropriate modifications to other proceedings whereby the parties request a third person to assist them in their attempt to reach an amicable settlement of their dispute.

### **ARTICLE 10.8**

*(Suspension in case of force majeure, death or incapacity)*

(1) Where the obligee has been prevented by an impediment that is beyond its control and that it could neither avoid nor overcome, from causing a limitation period to cease to run under the preceding Articles, the general limitation period is suspended so as not to expire before one year after the relevant impediment has ceased to exist.

(2) Where the impediment consists of the incapacity or death of the obligee or obligor, suspension ceases when a representative for the incapacitated or deceased party or its estate has been appointed or a successor has inherited the respective party's position. The additional one-year period under paragraph (1) applies accordingly.

### **ARTICLE 10.9**

*(Effects of expiration of limitation period)*

(1) The expiration of the limitation period does not extinguish the right.

## UNIDROIT Principles

(2) For the expiration of the limitation period to have effect, the obligor must assert it as a defence.

(3) A right may still be relied on as a defence even though the expiration of the limitation period for that right has been asserted.

### ARTICLE 10.10

*(Right of set-off)*

The obligee may exercise the right of set-off until the obligor has asserted the expiration of the limitation period.

### ARTICLE 10.11

*(Restitution)*

Where there has been performance in order to discharge an obligation, there is no right of restitution merely because the limitation period has expired.

## CHAPTER 11 — PLURALITY OF OBLIGORS AND OF OBLIGEEES

### SECTION 1: PLURALITY OF OBLIGORS

#### ARTICLE 11.1.1

*(Definitions)*

When several obligors are bound by the same obligation towards an obligee:

- (a) the obligations are joint and several when each obligor is bound for the whole obligation;
- (b) the obligations are separate when each obligor is bound only for its share.

#### ARTICLE 11.1.2

*(Presumption of joint and several obligations)*

When several obligors are bound by the same obligation towards an obligee, they are presumed to be jointly and severally bound, unless the circumstances indicate otherwise.

#### ARTICLE 11.1.3

*(Obligee's rights against joint and several obligors)*

When obligors are jointly and severally bound, the obligee may require performance from any one of them, until full performance has been received.

#### ARTICLE 11.1.4

*(Availability of defences and rights of set-off)*

A joint and several obligor against whom a claim is made by the obligee may assert all the defences and rights of set-off that are personal to it or that are common to all the co-obligors, but may not assert defences or rights of set-off that are personal to one or several of the other co-obligors.

#### ARTICLE 11.1.5

*(Effect of performance or set-off)*

Performance or set-off by a joint and several obligor or set-off by the obligee against one joint and several obligor discharges the other obligors in relation to the obligee to the extent of the performance or set-off.

## **Annex**

### **ARTICLE 11.1.6**

*(Effect of release or settlement)*

(1) Release of one joint and several obligor, or settlement with one joint and several obligor, discharges all the other obligors for the share of the released or settling obligor, unless the circumstances indicate otherwise.

(2) When the other obligors are discharged for the share of the released obligor, they no longer have a contributory claim against the released obligor under Article 11.1.10.

### **ARTICLE 11.1.7**

*(Effect of expiration or suspension of limitation period)*

(1) Expiration of the limitation period of the obligee's rights against one joint and several obligor does not affect:

(a) the obligations to the obligee of the other joint and several obligors; or

(b) the rights of recourse between the joint and several obligors under Article 11.1.10.

(2) If the obligee initiates proceedings under Articles 10.5, 10.6 or 10.7 against one joint and several obligor, the running of the limitation period is also suspended against the other joint and several obligors.

### **ARTICLE 11.1.8**

*(Effect of judgment)*

(1) A decision by a court as to the liability to the obligee of one joint and several obligor does not affect:

(a) the obligations to the obligee of the other joint and several obligors; or

(b) the rights of recourse between the joint and several obligors under Article 11.1.10.

(2) However, the other joint and several obligors may rely on such a decision, except if it was based on grounds personal to the obligor concerned. In such a case, the rights of recourse between the joint and several obligors under Article 11.1.10 are affected accordingly.

### **ARTICLE 11.1.9**

*(Apportionment among joint and several obligors)*

As among themselves, joint and several obligors are bound in equal shares, unless the circumstances indicate otherwise.

### **ARTICLE 11.1.10**

*(Extent of contributory claim)*

A joint and several obligor who has performed more than its share may claim the excess from any of the other obligors to the extent of each obligor's unperformed share.

### **ARTICLE 11.1.11**

*(Rights of the obligee)*

(1) A joint and several obligor to whom Article 11.1.10 applies may also exercise the rights of the obligee, including all rights securing their performance, to recover the excess from all or any of the other obligors to the extent of each obligor's unperformed share.

(2) An obligee who has not received full performance retains its rights against the co-obligors to the extent of the unperformed part, with precedence over co-obligors exercising contributory claims.

## **UNIDROIT Principles**

### **ARTICLE 11.1.12**

*(Defences in contributory claims)*

A joint and several obligor against whom a claim is made by the co-obligor who has performed the obligation :

- (a) may raise any common defences and rights of set-off that were available to be asserted by the co-obligor against the obligee ;
- (b) may assert defences which are personal to itself ;
- (c) may not assert defences and rights of set-off which are personal to one or several of the other co-obligors.

### **ARTICLE 11.1.13**

*(Inability to recover)*

If a joint and several obligor who has performed more than that obligor's share is unable, despite all reasonable efforts, to recover contribution from another joint and several obligor, the share of the others, including the one who has performed, is increased proportionally.

## **SECTION 2: PLURALITY OF OBLIGEEES**

### **ARTICLE 11.2.1**

*(Definitions)*

When several obligees can claim performance of the same obligation from an obligor:

- (a) the claims are separate when each obligee can only claim its share;
- (b) the claims are joint and several when each obligee can claim the whole performance;
- (c) the claims are joint when all obligees have to claim performance together.

### **ARTICLE 11.2.2**

*(Effects of joint and several claims )*

Full performance of an obligation in favour of one of the joint and several obligees discharges the obligor towards the other obligees.

### **ARTICLE 11.2.3**

*(Availability of defences against joint and several obligees)*

(1) The obligor may assert against any of the joint and several obligees all the defences and rights of set-off that are personal to its relationship to that obligee or that it can assert against all the co-obligees, but may not assert defences and rights of set-off that are personal to its relationship to one or several of the other co-obligees.

(2) The provisions of Articles 11.1.5, 11.1.6, 11.1.7 and 11.1.8 apply, with appropriate adaptations, to joint and several claims.

### **ARTICLE 11.2.4**

*(Allocation between joint and several obligees)*

(1) As among themselves, joint and several obligees are entitled to equal shares, unless the circumstances indicate otherwise.

(2) An obligee who has received more than its share must transfer the excess to the other obligees to the extent of their respective shares.



# INDEX

(Entries are keyed to the comments which follow each article, the number in square brackets indicating the number of the comment, where applicable)

## Abuse of rights

notion of, 1.7[2]  
See Good faith and fair dealing

## Acceptance

effective upon receipt, 2.1.6[4]  
indication of assent, 2.1.6[1]  
    by performance, 2.1.6[2], 2.1.6[4]  
    silence insufficient, 2.1.6[3]  
of an offer to release a right gratuitously, 5.1.9  
of oral offers, 2.1.7  
time of, 2.1.7  
    fixed period, 1.7[1], 2.1.8  
    holidays, 1.11[2], 2.1.8  
    late acceptance, 2.1.9[2]  
        caused by delay in transmission, 2.1.9[3]  
varying terms of offer, 2.1.11[1]  
    as rejection and counter-offer, 2.1.5[1], 2.1.11[2]  
    confirmation varying terms of contract compared, 2.1.12[1]  
    non-material alterations, 2.1.11[2]  
withdrawal of, 2.1.10  
    withdrawal of offer compared, 2.1.10  
See Contract, Formal requirements  
    Offer, Release by agreement, Terms of Contract, Standard terms, Writings in confirmation

## Agency

See Authority of Agents

## Adaptation

gross disparity, 3.2.7  
    and loss of right to avoid, 3.2.7[3]  
    resort to court, 3.2.7[3]  
hardship, 5.1.5[3], 6.2.2[3], 6.2.3[1]  
    resort to court, 6.2.3[6]  
See Avoidance, Hardship, Modification of contract

## Additional period for performance

grant of, 7.1.5[1]  
    effect of grant on other remedies, 7.1.5[2], 7.4.1[2]  
    termination after, 7.1.5[2], 7.3.1[4]

## Agreed payment for non-performance

currency of, 7.4.12  
    defined, 7.4.13[1]  
        exemption clause compared, 7.1.6[4], 7.1.6[6]  
        forfeiture distinguished, 7.4.13[4]  
        judicial penalty distinguished, 7.2.4[4]  
force majeure and, 7.4.13[2]  
liquidated damages, 6.1.13, 7.4.13[1]  
penalty clauses, 6.1.16[3], 6.1.17[2], 7.1.6[4], 7.4.7[3], 7.4.13[1], 7.4.13[2]  
    as clue to nature of obligation incurred, 5.5[3]  
validity of, 7.4.13[2]  
    grossly excessive, 7.4.13[3]  
See Damages, Non-performance

## Alternative dispute resolution

suspension of limitation period by, 10.7

## Application of Principles

See UNIDROIT Principles

## Arbitration

advisability of providing for, Preamble[4]  
applicable law, Preamble[4], Preamble[6]  
arbitral tribunals, 1.11[1]  
arbitration clause survives contract, 3.2.14  
clause contained in acceptance varying terms, 2.1.11[2]  
    in confirmation varying terms, 2.1.12[1]

## UNIDROIT Principles

in standard terms, 2.1.19[2],  
2.1.20[3]

ICSID Convention, Preamble[4]

suspension of limitation period  
by, 10.6

UNCITRAL Model Law, Preamble[4]

See UNIDROIT Principles

### Assignment of contracts

consent of the other party required,  
9.3.3

may be given in advance, 9.3.4

defence and rights of set off, 9.3.6

defined, 9.3.1

discharge of the assignor, 9.3.5

exclusion of, 9.3.2

rights transferred, 9.3.7

See Assignment of rights, Transfer of  
obligations

### Assignment of rights

assignability of non-monetary rights,  
9.1.3

defined, 9.1.1

assignor's undertakings, 9.1.15

by agreement, 9.1.1[1], 9.1.7

no form required, 1.2

consent of obligor not required,  
9.1.7[2]

exception, 9.1.7[3]

future rights, 9.1.5

include monetary sum and other  
performance, 9.1.1[2]

include all rights related to the  
right assigned, 9.1.14

transfer of instruments governed by

special rules excluded, 9.1.2[1]

transfers of business excluded,  
9.1.2[2]

non-assignment clauses, 9.1.9

notice of, to the obligor, 1.10, 9.1.10  
effect of, 9.1.10[1]

obligor's rights

to assert defences, 9.1.13[1]

to exercise set-off, 9.1.13[2]

to be compensated for additional  
costs, 9.1.3, 9.1.4, 9.1.8

to request adequate proof from the  
assignee, 9.1.12

partial, 9.1.4

successive, 9.1.11

without individual specification, 9.1.6

See Assignment of contracts, Payment,  
Set-off, Transfer of obligations

### Assurances

partial performance, 6.1.3[2]

right to demand, 7.3.4[1]

and termination, 7.3.4[3]

and withholding performance,  
7.3.4[2]

security or guarantee from third  
person, 7.3.4[2]

### Authority of agent

agent acting without or exceeding its  
authority, 2.2.5

does not bind the principal and the  
third party, 2.2.5[1]

exception apparent authority,  
2.2.5[2]

liable for damages, 2.2.6[1]

exception, third party know-  
ledge, 2.2.6[2]

agents of companies, 2.2.1[5]

disclosed agency, 2.2.3[1]

acting in the principal name not  
necessary, 2.2.3[3]

agent directly binds the principal  
and the third party, 2.2.3[2]

agent become party to the contract,  
2.2.3[4]

establishment of, 2.2.2

expressed or implied, 2.2.2[1]

extends to all acts necessary,  
2.2.2[2]

matters not covered by, 1.6[4]

authority conferred by law or

judicial authorisation, 2.2.1[4]

grounds for termination of  
authority, 2.2.10[1]

internal relation between principal  
and agent, 2.2.1[1], 2.2.7[5]

termination of, 2.2.10

authority of necessity, 2.2.10[3]

effective vis-à-vis third party,  
2.2.10[2]

undisclosed agency, 2.2.4[1]

affect only the relation between the  
agent and third party, 2.2.4[2]

exception, 2.2.4[3]

See Conflict of interest, Ratification,  
Sub-agency

## Index

### Avoidance

confirmation of contract excludes, 3.2.9  
damages, 3.2.16[1]  
    damages for non-performance  
    distinguished, 3.2.16[2]  
effects on third persons, not covered  
    1.3[3]  
ground for imputable to third person,  
    3.2.8  
    for whom a party is not responsible,  
        3.2.8[2]  
        prior to reliance on contract,  
            3.2.8[2]  
    for whom a party is responsible,  
        3.2.8[1]  
individual terms, 3.2.7[3], 3.2.12, 3.2.13  
notice of, 3.2.11[1]  
    court intervention unnecessary,  
        3.2.11[1]  
    effective upon receipt, 3.2.11[3]  
    form and content, no specific  
        requirement as to, 3.2.11[2]  
    interpretation of, 4.2[1], 4.4[1]  
    time period for, 3.2.12  
retroactive effect of, 3.2.14  
    restitution may be claimed, 3.2.15  
    survival of certain terms, 3.2.14[1]  
See Adaptation, Conflict of interest,  
Formal requirements, Fraud, Gross  
disparity, Mistake, Restitution,  
Threat

### Battle of forms

See Standard terms

### Best efforts

See Obligations

### Breach of contract

See Non-performance

### Cause

no need for, 3.1.2[2], 3.1.3  
    parties free to reintroduce, 3.1.4  
See Contract, Modification of contract,  
Termination

### Choice-of-law clause

in favour of UNIDROIT Principles,  
    Preamble[4(a)], 1.6[4]  
may survive contract, 3.2.14  
See UNIDROIT Principles

### “Closing”

notion of, 5.3.1[5]  
See Conditions

### Computation of time set by parties

notion of, 1.12

### Conclusion of contract

See Formation

### Conditions

effect of conditions, 5.3.2  
    non retroactive, 5.3.2[2]  
duty to preserve rights pending  
    fulfilment of a condition, 5.3.4  
interference with conditions, 5.3.3  
notion of, 5.3.1[1][2]  
    “closing”, 5.3.1[5]  
    condition entirely dependent on the  
        will of the obligor, 5.3.1[4]  
    resolutive condition, 5.3.1[3]  
        restitution in case of fulfilment  
        of resolutive condition, 5.3.5  
    suspensive condition, 5.3.1[3]  
See Restitution

### Conflict of interest

between agent and principal, 2.2.7  
    ground for avoidance of contract,  
        2.2.7[2]  
        exception, 2.2.7[4]  
        procedure, 2.2.7[3]  
See Authority of Agent, Avoidance

### Consideration

no need for, 3.1.2[1]  
    parties free to reintroduce, 3.1.4  
See Contract, Modification of contract,  
Termination

### *Contra proferentem* rule

See Interpretation of contract

### Contract

binding character of, 1.3[1], 6.2.1[1]  
    exceptions, 1.3[2]  
    vis-à-vis third persons, 1.3[3]  
divisible, 7.3.6[3]  
form, no requirements as to, 1.2[1]  
    exceptions under applicable law,  
        1.2[3]  
    parties may agree to stipulate, 1.2[4]

## UNIDROIT Principles

freedom of, 1.1[1]  
  basic principle of international  
  trade, 1.1[1]  
  applied to negotiations,  
  2.1.15[1]  
  applied to usages, 1.9[3]  
  exemption clauses and, 7.1.6[5]  
  limitations on, 1.1[2], 1.1[3]  
*pacta sunt servanda*, 1.3[1], 1.3[2]  
standard terms contract, 2.1.19[1]  
validity of mere agreement, 1.3[1],  
  2.1.2[1], 3.2  
  no need for *cause*, 3.2[2]  
  no need for consideration, 3.2[1]  
  open terms not in themselves  
    ground of invalidity, 2.1.14[2]  
  “real” contracts excluded, 3.2[3]  
See Electronic contracting

### Contracts in favour of third parties

See Third party rights

### Corruption

statutory prohibition of, 3.3.1[3]  
against principles of public policy,  
  3.3.1[3]  
See Mandatory rules, Illegality

### Course of dealing

See Practices

### Court

defined, 1.11[1]  
  includes arbitral tribunals, 1.11[1]  
penalties imposed by, 7.2.4[2], 7.2.4[6]  
suspension of limitation period by  
  judicial proceedings, 10.5  
See Adaptation, Damages, Judicial  
  penalties

### Cover

See Replacement transaction

### Cure by non-performing party

appropriateness of, 7.1.4[3]  
duty of co-operation and, 7.1.4[10]  
general principle allows, 7.1.4[1]  
notice of cure, 7.1.4[2]  
proper forms of, 7.1.4[6]  
right of aggrieved party to damages,  
  7.1.4[9]

right of aggrieved party to refuse cure,  
  7.1.4[4]  
other remedies suspended, 7.1.4[7]  
termination, relationship with, 7.1.4[8]  
timing of, 7.1.4[5]  
See Repair and replacement

### Damages

adaptation and, 3.2.10[4]  
avoidance and, 3.2.16[1]  
  damages for non-performance dis-  
  tinguished, 3.2.16[2]  
causality, 7.4.3[3]  
combined with other remedies, 7.1.1,  
  7.4.1[2]  
for agent acting without or exceeding  
  its authority, 2.2.6[1]  
for breach of confidentiality, 2.1.16[3]  
for future benefits lost, 7.4.2[2]  
  lost chances, 7.4.2[2]  
  quantification of, 7.4.3[1],  
  7.4.3[2]  
  lost profits, 7.4.2[2]  
for losses suffered, 7.4.2[2]  
  based on current price, 7.4.6[1]  
  how determined, 7.4.6[2]  
  based on price of replacement  
  transaction, 7.2.2[3], 7.4.5[1]  
  lost volume, 7.4.5[1]  
  failure to pay, 7.4.9[1]  
  no notice required, 7.4.9[1]  
  rate of interest, 7.4.9[2]  
  non-pecuniary harm, 7.4.2[5]  
  court determines form of  
  compensation, 7.4.2[5]  
  quantification of, 7.4.3[2]  
inconsistent with right to cure, 7.1.4[7]  
mitigation, duty of, 5.1.3, 7.4.5[1],  
  7.4.8[1]  
  reimbursement of expenses, 7.4.8[2]  
  replacement transaction, 7.4.5[1],  
  7.4.8[1]  
payment of, 7.4.11[1]  
  currency in which to assess, 7.4.12  
  indexation, 7.4.11[2]  
  interest on, 7.4.10  
pre-contractual liability, 2.1.15[2],  
  7.4.1[3]  
reliance not expectation, 2.1.15[2]  
reduction of, 7.4.2[3]  
  for contribution to harm, 7.4.7[1]  
  how defined, 7.4.7[2]

## Index

- how to apportion, 7.4.7[3]
- for harm due to failure to mitigate, 7.4.7[4]
- for loss avoided due to non-performance, 7.4.2[3]
- right to, 7.4.1[1]
  - full compensation, 7.4.2[1]
    - court may not reduce, 7.4.2[1]
  - harm must be certain, 7.4.3[1]
  - harm must be foreseeable, 7.4.4
  - results from non-performance, 7.4.1[1], 7.4.3[3]
    - fault irrelevant, 7.4.1[1]
    - no distinction between principal and accessory obligations, 7.4.1[1]
    - unless excused, 7.4.1[1]

See Agreed payment for non-performance, Avoidance, Interest, Non-performance, Replacement transaction, Remedies, Termination

### Definitions

See UNIDROIT Principles

### Dispatch principle

See Notice

### Domestic law

issues governed by, 1.2[3], 1.3[3], 1.6[4], 2.1.16[2], 2.2.1[1][4], 2.2.7[5], 2.2.9[5], 2.2.10[1], 3.1, 17[1], 6.1.9[2], 6.1.14[1], 7.2.4[3], 7.2.4[5], 7.2.4[7], 7.3.6[5], 7.4.10, 7.4.11[2], 9.1.2, 9.2.2, 9.3.2, 10.1[3], 10.5[4]

See Mandatory rules

### Duty of confidentiality

no general duty of, 2.1.16[1]

required by good faith and fair dealing, 2.1.16[2]

- damages recoverable, 2.1.16[3], 7.4.1[3]

### Duty of co-operation

See Obligations

### Duty to achieve specific result

See Obligations

### Duty to use best efforts

See Obligations

### Electronic contracting

automated contracting, 2.1.1[3]

clause requiring particular form for contract modification or termination, and, 2.1.18

conclusion of contracts not subject to particular requirements as to form, and, 1.2[1]

electronic communication in real time, 2.1.7

e-mail and time of dispatch of message, 2.1.8

e-mail and delay in transmission of message, 2.1.9[3]

standard terms and, 2.1.19[2] [3]

See Modification in a particular form, Notice, Writing

### Estoppel

See Inconsistent behaviour

### Exemption clauses

defined, 7.1.6[2]

- agreed payment for non-performance compared, 7.1.6[4], 7.1.6[6]
- forfeiture clauses distinguished, 7.1.6[3]
- limits or excludes liability for non-performance, 7.1.6[2], 7.4.1[1]

need for special rule on, 7.1.6[1]

validity of, 7.1.6[1], 7.1.6[5]

- grossly unfair, 7.1.6[1], 7.1.6[5]
  - court may ignore, 7.1.6[1]
  - court may not modify, 7.1.6[6]
- full compensation applies, 7.1.6[6]

### Fair dealing

See Good faith and fair dealing

### Force majeure

defined, 7.1.7

- in contract practice, 7.1.7[4]
- related civil and common law doctrines, 7.1.7[1]

effects of, 7.1.7[2], 7.4.1[1], 7.4.7[3], 7.4.9[1]

temporary impediment, 7.1.7[2]

## UNIDROIT Principles

hardship distinguished, 6.2.2[6],  
7.1.7[3]  
interference by other party as, 7.4.1[2],  
7.4.7[3]  
notice of impediment, 7.1.7  
suspension of limitation period by, 10.8  
See Agreed payment for non-performance, Hardship, Interference by other party, Non-performance, Termination

### Formal requirements

freedom from, 1.2  
as contracts, 1.2[1]  
as regards notice, 1.10[1]  
as to statements and other unilateral acts, 1.2[2]  
overridden by applicable law, 1.2[3]  
stipulated by parties, 1.2[4], 2.1.13[2]  
merger clause, 2.1.17  
modification in a particular form,  
2.1.18

### Formation of contract

automated contracting, 2.1.1[3]  
conclusion of contract dependent on,  
2.1.13  
agreement on specific matters,  
2.1.13[1]  
agreement in a particular form,  
2.1.13[2]  
manner of, 2.1.1  
by acceptance of an offer, 2.1.1[1]  
by conduct sufficient to show  
agreement, 2.1.1[2]  
terms deliberately left open, 2.1.14  
See Closing

### Fraud

adaptation on ground of, 3.2.10[1]  
avoidance on ground of, 3.2.5[1],  
3.2.5[2]  
time period for notice of, 3.2.12  
damages, 7.4.1[3]  
defined, 3.2.5[1], 3.2.5[2]  
mistake distinguished, 3.2.5[1],  
3.2.5[2], 3.2.10[1]  
imputable to third person, 3.2.8  
for whom a party is not responsible,  
3.2.8  
for whom a party is responsible,  
3.2.8

provision on mandatory, 3.1.4

### Freedom of contract

See Contract

### Frustration of purpose

See Hardship

### Good faith and fair dealing

criterion for supplying of omitted  
terms, 4.8[3]  
of omitted price term, 5.1.7[1]  
duty of co-operation and, 5.1.3, 6.1.6[3],  
6.2.3[5], 7.1.2[1]  
implied obligation, 5.1.1, 5.1.2, 6.2.3[5]  
in international trade, 1.7[3]  
underlying general principle, 1.6[3],  
1.7[1]  
mandatory nature of, 1.5[3], 1.7[4]  
See Abuse of rights, Duty of confidentiality, Inconsistent behaviour, Negotiations, Obligations

### Gross disparity

adaptation on ground of, 3.2.7[1], 3.2.7  
[3]  
avoidance on ground of, 3.2.7[1], 7.1.6[1]  
advantage must be unjustifiable,  
3.2.7[2]  
price excessive, 3.2.7[2]  
time period for notice of, 3.2.12  
damages arising out of, 7.4.1[3]  
hardship distinguished, 3.2.7[1]  
imputable to third person, 3.2.8  
for whom a party is not responsible,  
3.2.8[2]  
for whom a party is responsible,  
3.2.8[1]  
provision on mandatory, 3.1.4

### Hardship

defined, 6.2.2  
in contract practice, 5.5[3], 6.2.2[7]  
effects of, 6.2.3, 7.2.2[3], 7.4.1[1]  
exceptional character of, 6.2.3[4]  
force majeure distinguished, 6.2.2[6],  
7.1.7[4]  
gross disparity distinguished, 3.2.7[1]  
renegotiations, 6.2.3[1]  
good faith, 6.2.3[5]  
request for, 6.2.3[2], 6.2.3[3],

## Index

withholding performance,  
6.2.3[4]  
resort to court in case renegotiations fail, 6.2.3[6]  
measures court may take,  
6.2.3[7]  
termination of contract for indefinite period distinguished, 5.1.8  
See Force majeure, Price

### Illegality

contracts infringing mandatory rules,  
3.3.1  
effects of infringement prescribed by mandatory rule infringed,  
3.3.1[4]  
according to what is reasonable in the circumstances, 3.3.1[5]  
criteria, 3.3.1[6]  
restitution, 3.3.2  
according to what is reasonable in the circumstances, 3.3.2[1]  
criteria, 3.3.2[2]  
See Corruption, Mandatory rules, Restitution

### Impossibility

See Initial impossibility, Interference by other party, Force majeure, Hardship, Payment, Public permission requirements, Remedies

### Imprévision

See Hardship

### Imputation

of non-monetary obligations, 6.1.13  
of payments, 6.1.12

### Inconsistent behaviour

prohibition of, 1.8  
application of general principle of good faith and fair dealing, 1.7, 1.8[1]  
understanding caused by one party and reasonably relied upon, 1.8[2]  
means to avoid detriment caused by, 1.8[3]  
See Authority of agent, Interpretation of contract, Interpretation of statements and other conduct, Modification in particular from, Offer

### Initial impossibility

lack of legal title to dispose, 3.1.3[2]  
lack of capacity distinguished,  
3.1.3[2]  
performance impossible from outset,  
3.1.3[1], 3.2.2[2]  
*objet* need not be possible, 3.1.3[1]  
validity of contract unaffected by,  
3.1.3[1], 3.1.3[2], 7.2.2[3]  
non-mandatory character of provision, 1.5[3], 3.1.4  
rules on non-performance apply,  
3.1.3[1], 3.1.3[2]  
See Force majeure, Hardship, Public permission requirements

### Integration clause

See Merger clauses

### Interest

failure to pay, 7.4.9[1]  
accrues from time payment due,  
7.4.9[1]  
additional damages recoverable,  
7.4.9[3]  
rate of interest, 7.4.9[2]  
on damages, 7.4.10  
accrues from time of non-performance, 7.4.10  
compound interest, 7.4.10  
See Agreed payment for non-performance, Damages

### Interference by other party

excuse for own non-performance, 7.1.1  
non-performance due to act or omission of other party, 7.1.2[1]  
non-performance due to event for which other party bears risk,  
7.1.2[2]  
other party may not terminate,  
7.1.2[1]  
performance impossible due to,  
7.1.2[1], 7.4.7[3]  
partial impediment, 7.1.2[1], 7.4.7[3]  
See Damages

### Interpretation of contract

circumstances relevant to, 4.3[1]

## UNIDROIT Principles

when applying reasonableness test, 4.3[2],  
when applying subjective test, 4.3[2],  
determination of kind of obligation involved, 5.1.5[1]  
interpretation of UNIDROIT Principles distinguished, 1.6[1]  
multiple language versions, 4.7  
rules governing, 4.1, 4.3  
    all terms to be given effect, 4.5  
    common intention to prevail, 3.2.2[1], 4.1[1]  
    *contra proferentem* rule, 4.6  
    reasonable person standard, recourse to, 4.1[2]  
    reference to contract as a whole, 4.4[1]  
        no hierarchy among terms, 4.4[2]  
    regard to relevant circumstances, 4.1[3]  
See Inconsistent behaviour, Interpretation of statements and other conduct, Negotiations, Obligations, Practices, Price, Standard terms, Usages, Terms of contract

### Interpretation of statements and other conduct

circumstances relevant to, 4.3[1]  
    when applying reasonableness test, 4.3[2]  
    when applying subjective test, 4.3[2]  
rules for interpretation of contract  
    apply by analogy, 4.2[1]  
    intention to prevail, 4.2[1]  
    reasonable person standard, recourse to, 4.2[1]  
    reference to statement as a whole, 4.4[1]  
    regard to relevant circumstances, 4.2[2]  
See Inconsistent behaviour, Interpretation of contract, Notice, Unilateral declarations

### Judicial penalties

beneficiary, 7.2.4[3]  
damages and agreed payment distinguished, 7.2.4[4]

enforcement of in other countries, 7.2.4[7]  
form and procedure, 7.2.4[5]  
mandatory rules of forum pertaining to, 7.2.4[3]  
when appropriate, 7.2.4[2]  
See Right to performance

### *Lex mercatoria*

See UNIDROIT Principles

### Liquidated damages

See Agreed payment for non-performance

### Limitation periods

distinguished from special time limits, 10.1[2]  
expiration of, 10.9  
    does not extinguish the right, 10.9[1]  
    must be raised as a defence, 10.9[2]  
    not a ground for restitution, 10.11[1]  
general period of, 10.2  
    commencement, 10.2(1)[7]  
mandatory rules prevail, 1.4, 10.1[3]  
maximum period of, 10.2[9]  
    commences, 10.2[5]  
modification by parties, 10.3, 10.2[2]  
    10.4[4]  
    limits of, 10.3[2]  
    time of, 10.3[3]  
Principles provide a two-tier system, 10.2[3][4]  
renewal of, 10.4  
    by acknowledgement of rights, 10.4[1]  
    commencement, 10.4[2]  
    novation to be distinguished, 10.4[3]  
suspension of, 10.2[2], 10.8  
    by alternative dispute resolution, 10.7  
    by arbitral proceedings, 10.6  
    by impediments, 7.1.7, 10.8  
        effects of impediments, 10.8[1]  
        additional period of deliberation, 10.8[2]  
    by judicial proceedings, 10.5  
        include bankruptcy or insolvency proceedings, 10.5[4]



## Index

See Alternative dispute resolution,  
Arbitration, Court, Force majeure,  
Set-off

### Mandatory Rules

of domestic law, 1.4  
    broad notion of, 1.4[2]  
    examples of, 1.2[3], 1.4[2], 3.3.1,  
        3.3.2, 6.1.9[2], 6.1.14[1], 7.2.4[3],  
        7.2.4[5], 7.2.4[7], 10.1[3]  
    UNIDROIT Principles subject to,  
        1.1[3], 1.4[1]  
        when Principles govern  
            contract, Preamble[3],  
            Preamble[4], 1.4[4],  
        when Principles incorporated  
            into contract, 1.4[3]  
of UNIDROIT Principles, 1.5[3]  
    examples of, 1.5[3]  
See Contract, Illegality

### Merchants

UNIDROIT Principles do not require that  
parties be, Preamble[2]

### Merger clauses

defined, 2.1.17  
standard terms containing, 2.1.21  
See Negotiations

### Mistake

avoidance due to, 3.2.2  
    conditions concerning mistaken  
        party, 3.2.2[3]  
    conditions concerning non-mis-  
        taken party, 3.2.2[2]  
    mistake must be sufficiently  
        serious, 3.2.2[1]  
    time period for notice of, 3.2.12  
    damages, 7.4.1[3]  
caused by the inconsistent behaviour of  
a party, 1.8[2]  
defined, 3.2.1[1]  
    mistake of law equated with  
        mistake of fact, 3.2.1[1]  
fraud distinguished, 3.2.5[2], 3.2.10[1]  
imputable to third person, 3.2.8[1],  
    3.2.8[2], 5.1.7[3]  
in expression or transmission, 1.10[3],  
    3.2.6[1]  
loss of right to avoid, 3.2.10[3]  
    damages not precluded, 3.2.10[4]

    decision to perform must be made  
        promptly, 3.2.10[2]  
    precluded after notice of avoidance  
        relied on, 3.2.7[3], 3.2.10[3]  
non-mandatory character of provisions  
relating to, 1.5[3], 3.1.4  
non-performance distinguished,  
    3.2.1[2], 3.2.4[1]  
    remedy for non-performance  
        preferred, 3.2.4[1], 3.2.4[2]

### Modification in a particular form

clause requiring, 2.1.18  
    reliance on modification not in the  
        particular form notwithstanding,  
        2.1.18  
standard terms containing, 2.1.21  
See Inconsistent behaviour

### Modification of contract

by agreement of parties, 1.3[2], 3.1.2  
    no need for consideration, 3.1.2[1]  
    no need for *cause*, 3.1.2[2]  
no requirement as to form, 1.2[1]  
    exceptions under applicable law,  
        1.2[3]  
    unless agreed upon, 1.2[4]  
See Inconsistent behaviour, Modifi-  
cation in particular form

### Negotiations

breaking off of, 2.1.15[3]  
conclusion of contract dependent on  
    agreement on specific matters,  
        2.1.13[1]  
conclusion of contract dependent on  
    agreement in a particular form,  
        2.1.13[2]  
duty of confidentiality and, 2.1.16[2]  
freedom of, 2.1.15[1]  
good faith and fair dealing in, 1.7[1],  
    2.1.15[2], 5.1.2, 6.1.14[2]  
    liability for failure to observe,  
        2.1.15[2], 2.1.15[3]  
interference in by third person, 3.2.8[1],  
    3.2.8[2]  
interpretation of contract and, 4.3[2],  
    4.6  
    merger clause, 2.1.17, 4.3[3]  
    supplying of omitted terms, 4.8[3]  
    pertaining to replacement transac-  
        tion, 7.4.5[2]

## UNIDROIT Principles

standard terms and, 2.1.19[2], 2.1.20[2]  
negotiated terms prevail, 2.1.21  
terms deliberately left open, 2.1.14  
See Hardship

### No oral modification clause

See Modification in particular form

### Non-performance

anticipatory, 1.10[3], 7.3.3  
defined, 7.1.1  
earlier performance normally  
constitutes, 6.1.5[1], 6.1.5[4]  
excuses for, 7.1.1, 7.4.1[1]  
exemption clause, 7.4.1[1]  
interference by other party,  
7.1.2[1], 7.1.2[2]  
force majeure, 5.1.4[2], 7.1.7[2],  
7.4.1[1], 7.4.7[3], 7.4.9[1],  
7.4.13[2]  
withholding performance, 7.1.3  
fundamental, 7.1.5[2], 7.1.7[2], 7.3.1[2],  
7.3.3, 7.3.4  
circumstances constituting, 7.3.1[3]  
mistake distinguished, 3.2.1[2], 3.2.4[1]  
remedy for non-performance  
preferred, 3.2.4[1], 3.2.4[2]  
of obligation of best efforts, 5.1.4[2]  
failure to achieve a specific result  
distinguished, 5.1.4[2]  
partial performance normally consti-  
tutes, 6.1.3[2], 6.1.3[4]  
See Agreed payment for non-perform-  
ance, Assurances, Cure by non-  
performing party, Damages, Force  
majeure, Interference by other party,  
Remedies, Repair and replacement,  
Replacement transaction, Right to  
performance, Termination

### Notice

defined, 1.10[1]  
effective upon receipt, 1.10[2]  
dispatch principle to be stipulated,  
1.10[3]  
“reaches” defined, 1.10[4]  
in case of electronic notice,  
1.10[4]  
electronic notice, 1.10[1][4]  
interpretation of, 4.2[1]  
no requirement as to form, 1.10[1]  
See Acceptance, Additional period for

performance, Avoidance, Cure by  
non-performing party, Damages,  
Electronic contracting, Force  
majeure, Fraud, Mistake, Public  
permission requirements, Remedies,  
Termination

### Obligations

best efforts or specific result, 5.1.4[1],  
7.4.1[1]  
criterion for evaluating perform-  
ance, 5.1.4[2], 7.4.1[1]  
determining which applies, 5.5[1]  
contract language, 5.1.5[2]  
degree of risk involved,  
5.1.5[4]  
price or other term as clue,  
5.1.5[3]  
when obligee has influence  
over performance, 5.1.5[5]  
duty of co-operation, 5.1.3  
cure by non-performing party and,  
7.1.4[10]  
duty to mitigate damages, 5.1.3, 7.4.5[1],  
7.4.8[1]  
implied, 5.1.1  
sources of, 5.1.2  
quality of performance due, 5.1.6  
average quality, 5.1.6[1]  
reasonable quality, 5.1.6[2]  
See Damages, Duty of confidentiality,  
Good faith and fair dealing, Inter-  
pretation of contract, Practices,  
Terms of contract, Usages

### Offer

defined, 2.1.2  
definiteness, 2.1.2[1]  
intention to be bound, 2.1.2[2]  
effective upon receipt, 2.1.3[1]  
irrevocable, 2.1.4[2]  
rejection terminates, 2.1.5[1]  
reliance on irrevocability, 2.1.4[2]  
inconsistent behaviour and,  
2.1.4[2],  
withdrawal of, 2.1.3[2]  
rejection of, 2.1.5[1]  
may be implied, 2.1.5[1]  
terminates offer, 2.1.5[1]  
revocation of, 2.1.4  
withdrawal of, 2.1.3[2]

## Index

revocation of offer distinguished,  
2.1.3[2]  
withdrawal of acceptance com-  
pared, 2.1.10  
See Acceptance, Contract, Formal  
requirements, Negotiations, Price,  
Release by agreement, Standard  
terms, Terms of contract, Writings in  
confirmation

### ***Ordre public transnational***

notion, 1.4[4]  
relevance in international arbitration,  
1.4[4]  
See Mandatory rules, Illegality

### ***Pacta sunt servanda***

See Contract

### **Party autonomy**

See Contract

### **Payment**

accelerated, 1.7[1]  
currency of account, 6.1.9  
different from that of place for  
payment, 6.1.9[1]  
*effectivo* clause 6.1.9[1], 6.1.9[2]  
impossibility to make payment in,  
6.1.9[2]  
not specified, 6.1.10  
exchange rate applicable to, 6.1.9[3]  
form of, 6.1.7  
cheque or other instrument,  
6.1.7[1]  
acceptance of presumed condi-  
tional on solvency, 6.1.7[2]  
transfer, 6.1.8[1]  
when effective, 6.1.8[2]  
mandatory rules pertaining to, 6.1.9[2],  
6.1.14[1]  
on delivery, 6.1.4[1]  
in agreed instalments, 6.1.4[2]  
place for, 1.6[4], 6.1.6[2], 6.1.7[1],  
6.1.8[1], 6.1.9[1], 6.1.10  
See Assignment of rights, Imputation,  
Right to performance, Set-off

### **Penalty clause**

See Agreed payment for non-  
performance

### **Performance**

costs of, 6.1.11  
earlier, 6.1.5[1]  
acceptance of, 6.1.5[3], 6.1.5[4]  
additional expenses entailed by,  
6.1.5[4]  
rejection of, 6.1.5[1]  
subject to legitimate interest,  
6.1.5[2]  
late performance, 7.1.5[1]  
damages, 7.1.5[2], 7.4.1[2]  
order of, 6.1.4  
simultaneous, 6.1.4[1]  
when one party requires period of  
time, 6.1.4[2]  
withholding of performance, relation  
to, 6.1.4[3], 7.1.3  
overdue, 7.3.2[2]  
partial, 6.1.3[1]  
acceptance of, 6.1.3[2], 6.1.3[4]  
additional expenses entailed  
by, 6.1.3[4]  
distinguished from instalment,  
6.1.3[1]  
rejection of, 6.1.3[2]  
subject to legitimate interest,  
6.1.3[3]  
place for, 6.1.6[1]  
change in place of business, 6.1.6[3]  
of monetary obligation, 6.1.6[2]  
funds transfer, 6.1.8[1]  
of non-monetary obligation, 6.1.6[2]  
quality of performance due, 5.1.6  
average quality, 5.1.6[1]  
reasonable quality, 5.1.6[2]  
time of, 6.1.1  
earlier performance by other party,  
6.1.5[3]  
instalments, 6.1.2  
withholding of, 7.1.3  
pending assurances, 7.3.4[2]  
See Additional period for performance,  
Assurances, Hardship, Imputation,  
Non-performance, Obligations,  
Payment, Public permission  
requirements, Right to performance

### **Plurality of obligees**

notion of, 11.2.1[1]  
joint and several claims, 11.2.1[3]  
effects of, 11.2.2  
availability of defences and

## UNIDROIT Principles

- rights of set-off, 11.2.3
- separate claims, 11.2.1[3]
- joint claims, 11.2.1[3]
- no presumption of particular type of claims, 11.2.1[4]
- See Plurality of obligors

### Plurality of obligors

- notion of, 11.1.1[1]
  - joint and several obligations, 11.1.1[3]
    - presumption of, 11.1.2
    - apportionment among joint and several obligors, 11.1.9
    - availability of defences and rights of set-off, 11.1.4
  - contributory claims, 11.1.10
    - defences in, 11.1.12
  - inability to recover, 11.1.13
  - effect of expiration or suspension of limitation period, 11.1.7
  - judgment, 11.1.8
  - performance and set-off, 11.1.5
  - release or settlement, 11.1.6
  - subrogation in obligee's right, 11.1.11
    - obligee's rights against joint and several obligors, 11.1.3
  - separate obligations, 11.1.1[3]
- See Plurality of obligees

### Practices

- binding character of, 1.9[1]
  - establishment of particular practice, 1.9[2]
  - exclusion of particular practice, 1.9[2]
- circumstance relevant to interpretation, 4.3[2]
- fraudulent, 3.2.5[2]
- means of overcoming indefiniteness, 2.1.2[1]
- modes of acceptance and, 2.1.6[3], 2.1.6[4]
- restrictive trade, 1.4[3], 2.1.16[2], 3.2.7[2]
- source of implied obligation, 5.1.2, standard terms and course of dealing, 2.1.19[3]
- UNIDROIT Principles superseded by, 1.9[6]
- See Usages

### Pre-contractual liability

- See Damages, Good faith and fair dealing, Negotiations

### Price

- clue to nature of obligation incurred, 5.1.5[3]
- determination, 5.1.7[1]
  - by one party, 5.1.7[2]
  - by reference to external factor, 5.1.7[4]
  - by third person, 5.1.7[3]
- reasonable price, 5.1.7[1], 5.1.7[2], 5.1.7[3]
- recourse to other provisions of UNIDROIT Principles, 5.1.7[1]
- UNIDROIT Principles' solutions inappropriate, 4.8[2]
- indefinite in offer, 2.1.11[1]
- modified in acceptance, 2.1.11[2]
- renegotiation, 6.2.3[1]
  - adaptation, 6.2.3[7]
  - price indexation clause, 6.2.3[1]
- See Payment

### Principles

- See UNIDROIT Principles

### Private international law

- law governing contract and, Preamble[4]
- mandatory rules determined on basis of, 1.4[4]
- public permission requirements determined on basis of, 6.1.14[1]
- See Domestic law, Mandatory rules, Public permission requirements, UNIDROIT Principles

### Public permission requirements

- application for public permission, 6.1.14
  - cost of, 6.1.15[2]
  - duty of best efforts, 6.1.14[4]
  - notice of outcome, 6.1.15[3], 6.1.15[4]
    - failure to notify of, 6.1.15[5]
  - party required to file, 1.10[2], 6.1.14[2]
  - time of filing, 6.1.15[1]
- defined, 6.1.14[1]
- determination of, 6.1.14[1]

## Index

on basis of private international law, 6.1.14[1], 6.1.14[2]  
duty to inform of existence of, 6.1.14[2]  
permission neither granted nor refused, 6.1.16[1]  
    either party may terminate, 6.1.16[1], 6.1.16[2]  
    unless affecting individual terms only, 6.1.16[3]  
permission refused, 6.1.17[1]  
    affecting validity of contract, 6.1.14[1], 6.1.17[2], 7.2.2[3]  
    rendering performance impossible, 6.1.14[1], 7.2.2[3]  
        rules for non-performance apply, 6.1.17[2], 7.2.3[2]  
See UNIDROIT Principles, Private international law

### Ratification

effects of, 2.2.9[2]  
excluded by third party, 2.2.9[4]  
notion of, 2.2.9[1]  
third person's right not affected by, 2.2.9[5]  
time of, 2.2.9[3]  
See Authority of Agents, Formal requirements

### Receipt principle

See Notice

### Release by agreement

gratuitously, 5.1.9  
per value, 5.1.9  
See Acceptance, Offer

### Reliance

See Adaptation, Avoidance, Damages, Inconsistent behaviour, Offer, Writings in confirmation

### Remedies

change of, 7.2.5[1], 7.2.5[2]  
    notice of, 7.2.5[4]  
    time limits, 7.2.5[4]  
    unenforceable decision, 7.2.5[3]  
contribution to harm restricts exercise of, 7.4.7[1]  
cumulation of, 7.1.1, 7.4.1[2]  
for breach of duty of confidentiality,

2.1.16[3]  
for early performance, 6.1.5[4]  
for failure to obtain public permission, 6.1.16[2]  
for inability to pay in currency of account, 6.1.9[2]  
for non-performance, 3.2.1[2], 3.2.4[1], 3.2.4[2]  
    distinguished from remedies for mistake, 3.2.1[2]  
    preferred to remedies for mistake, 3.2.4[1], 3.2.4[2]  
for partial performance, 6.1.3[2], 6.1.3[4]  
in case of impossibility, 7.2.2[3]  
in case of notice of cure, 7.1.4[7]  
withholding performance, 7.1.3, 7.1.4[7], 7.1.5  
See Adaptation, Additional period for performance, Avoidance, Cure by non-performing party, Damages, Repair and replacement, Replacement transaction, Restitution, Right to performance, Termination

### Renunciation of rights

See Release by agreement

### Repair and replacement

form of, 7.1.4[6]  
of defective performance, 7.2.3[2]  
    unreasonable effort or expense, 7.2.3[3]

### Replacement transaction

availability of precluding specific performance, 7.2.2[3]  
damages based on, 7.2.2[3], 7.4.5[1]  
    includes cost of negotiations, 7.4.5[2]  
required by duty to mitigate, 7.4.5[1], 7.4.8[1]  
required by usages, 7.2.1, 7.4.5[1]

### Restitution

avoidance and, 3.2.15  
    restitution in kind, 3.2.15[1]  
        allowance made in money, 3.2.15[2]  
    allocation of risk, 3.2.15[3]  
    benefits, 3.2.15[5]

## UNIDROIT Principles

- compensation for expenses,  
3.2.15[4]
- fulfilment of resolutive condition and,  
5.3.5
- illegality and, 3.3.2
- termination and, 7.3.6, 7.3.7
  - contracts to be performed at one  
time, 7.3.6
    - restitution in kind, 7.3.6[2]
    - allowance made in money,  
7.3.6[3]
  - allocation of risk, 7.3.6[4]
  - benefits, 7.3.6[6]
  - compensation for expenses 7.3.6[5]
  - contracts to be performed over a  
period of time, 7.3.7
    - divisible contract, 7.3.6[1]
    - restitution only in respect of  
period after termination,  
7.3.6[1]

See Avoidance, Conditions, Illegality,  
Termination

### Right to performance

- defective performance, 7.2.3[1]
  - repair and replacement, 7.2.3[2]
  - restrictions, 7.2.3[3]
- non-performance of monetary obliga-  
tion, 7.2.1
  - exceptions, 7.2.1
- non-performance of non-monetary  
obligation, 7.2.2[1]
  - damages may be combined with,  
7.4.1[2]
  - exceptions to right to performance,  
7.1.1, 7.2.2[3]
    - additional period for perform-  
ance granted, 7.1.5[2]
  - impossibility, 7.2.2[3]
  - non-performance excused,  
7.1.1, 7.3.1[1]
  - performance of exclusively  
personal character, 7.2.2[3]
  - replacement transaction avail-  
able, 7.2.2[3]
  - unreasonable burden, 7.2.2[3]
- remedy not discretionary, 7.2.2[2]
- right to change of remedy, 7.2.5[1]
  - defaulting party unable to per-  
form, 7.2.5[2]
- specific performance unenforce-  
able, 7.2.5[3]

See Judicial penalties, Remedies,  
Repair and replacement, Replace-  
ment transactions

### Scope of Principles

See UNIDROIT Principles

### Set-off

- conditions of,
  - obligations owed to each other,  
8.1[2]
  - obligations of the same kind, 8.1[3]
  - first party obligation performable,  
8.1[4]
  - other party's obligation ascertained,  
8.1[5]
  - other party's obligation due, 8.1[6]
  - obligations arising from the same  
contract, 8.1[7]
- definition of, 8.1[1]
  - first party, 8.1[1]
  - other party, 8.1[1]
- effective at the time of notice, 8.5[2]
- effects of, 8.5
  - discharge the obligations, 8.5[1]
- exercised by notice, 8.3, 1.10
  - content of, 8.4
- foreign currency, 8.2

See Assignment of rights, Limitation  
periods, Payment, Performance,  
Right to performance

### Specific performance

See Right to performance

### Standard terms

- battle of forms, 2.1.22[2]
  - defined, 2.1.22[1]
  - last shot doctrine, 2.1.22[2],  
2.1.22[3]
  - knock out doctrine, 2.1.22[3]
- defined, 2.1.19[2]]
- interpretation of, 4.1[4], 4.6
- surprising terms in, 2.1.20[1]
  - by virtue of content, 2.1.20[2]
  - by virtue of language, 2.1.20[3]
  - express acceptance of, 2.1.20[4]
- when binding, 2.1.19[3], 2.1.20[1]
  - by express acceptance, 1.5[2],  
2.1.19[3], 2.1.20[1], 2.1.20[4]
  - by implied incorporation, 2.1.19[3]

See Gross disparity, Interpretation of

## Index

contract, Merger clauses, Negotiations, Practices, Terms of contract, Usages

### Sub-agency

binds the principal and third party, 2.2.8[3]  
exception, 2.2.5[1], 2.2.8[3]  
implied authority of agent to appoint, 2.2.8[2]  
role of, 2.2.8[1]  
See Authority of Agents

### Supplementation of Principles

See UNIDROIT Principles

### Supplying omitted terms

See Terms of contract

### Termination

anticipatory non-performance and, 7.3.3  
expectation of non-performance must be reasonable, 7.3.4[1]  
by agreement of parties, 1.3[2], 3.1.2  
no need for *cause*, 3.1.2[2]  
no need for consideration, 3.1.2[1]  
by unilateral notice, 7.3.1[1]  
after demand for assurances, 7.3.4[3]  
after *Nachfrist*, 7.1.5[2], 7.3.1[4]  
based on non-performance, 7.1.1  
applies even if non-performance excused, 7.1.1  
non-performance must be fundamental, 7.1.5[2], 7.1.7[2], 7.3.1[2], 7.3.3  
contract for indefinite period, 5.1.8  
effects of, 7.3.5[1]  
does not affect damage claims, 7.1.1, 7.3.5[2], 7.4.1[2]  
on third persons not covered, 1.3[3]  
provisions unaffected by, 7.3.5[3]  
force majeure and, 6.2.2[6], 7.1.7[2]  
hardship and, 3.2.7[1], 6.2.3[7]  
inconsistent with notice of cure, 7.1.4[7]  
notice of, 7.3.2[1], 7.3.3  
effective upon receipt, 7.3.2[4]  
interpretation of, 4.2[1], 4.4[1]  
no requirement as to form, 1.10[1]  
time period for, 7.2.5[4], 7.3.2[3]  
right to damages after, 7.1.1, 7.3.5[2], 7.4.1[2]

based on current price, 7.4.6[1]  
additional harm, 7.4.6[3]  
based on replacement transaction, 7.2.2[3], 7.4.5[1]  
additional harm, 7.4.5[2]  
lost volume, 7.4.5[1]  
right to restitution after, 7.3.6[1]  
allowance made in money, 7.3.6[2], 7.3.6[4]  
benefits, 7.3.6[6]  
compensation for expenses, 7.3.6[5]  
divisible contract, 7.3.6[3]  
rights of third persons unaffected, 7.3.6[7]  
See Additional period for performance, Assurances, Cure by non-performing party, Damages, Modification in particular form, Non-performance, Public permission requirements, Restitution

### Terms of contract

avoidance of individual terms, 3.2.7[3], 3.2.12, 3.2.13  
deliberately left open, 2.1.14[1]  
contract validity and, 2.1.14[2]  
to be determined by third person, 2.1.14[1], 2.1.14[2]  
effect of subsequent failure to determine, 2.1.14[3]  
implied obligations, 5.1.1  
sources of, 5.1.2  
insistence on specific terms, 2.1.13[1]  
supplying of omitted terms, 4.8[1]  
by UNIDROIT Principles, 2.1.2[1], 4.8[2]  
criteria for in absence of general rule, 4.8[3]  
interpretation of contract terms distinguished, 4.8[1]  
unconscionable, 7.1.6[1]  
See Interpretation of contract, Interpretation of statements or other conduct, Obligations, Price, Standard terms

### Third party rights

conferred by express or implied agreement, 5.2.1  
beneficiary, 5.2.1  
exclusion or limitation of liability of, 5.2.3  
renunciation of rights of, 5.2.6

## UNIDROIT Principles

must be identifiable, 5.2.2  
promisor, 5.2.1  
defence against beneficiary, 5.2.4  
promisee, 5.2.1  
revocation or modification of beneficiary's rights, 5.2.5  
exception, 5.2.5  
See Contract

### Third persons

effect of contract on, not covered, 1.3[3]  
interference of in negotiations, 3.2.8  
for whom a party is not responsible, 3.2.8[2]  
for whom a party is responsible, 3.2.8[1]  
rights of third persons not covered, 7.3.6[5], 2.2.9[5]  
removal of as form of cure, 7.2.3[2]  
See Avoidance, Fraud, Gross disparity, Mistake, Threat

### Threat

adaptation of contract on ground of, 3.2.10[1]  
avoidance of contract on ground of, 3.2.6, 3.2.10[1]  
conditions for, 3.2.6[1], 3.2.6[2]  
time period for notice of, 3.2.12  
damages, 7.4.1[3]  
imputable to third person, 3.2.8  
for whom a party is not responsible, 3.2.8[2]  
for whom a party is responsible, 3.2.8[1]  
provision relating to mandatory, 3.1.4  
to reputation or economic interests, 3.2.6[3]

### Transfer of obligations

by agreement, 9.2.1  
between the original obligor and the new obligor, 9.2.1[1], 9.2.3  
consent of obligee required, 9.2.1[3]  
may be given in advance, 9.2.4  
between the obligee and the new obligor, 9.2.1[2]  
discharge of original obligor, 9.2.5

obligee's choice: full discharge, 9.2.5[2]  
obligee's choice: original obligor retained as subsidiary obligor, 9.2.5[3]  
obligee's choice: original obligor retained as joint and several obligor – default rule, 9.2.5[4]  
new obligor's rights  
to assert defences, 9.2.7[1][2]  
to exercise set-off, 9.2.7[3]  
rights related, 9.2.8  
third party performance, 9.2.6  
transfer under the special rules governing transfers of obligations in the course of transferring a business excluded, 9.2.2  
See Assignment of contracts, Performance, Set-off

### Transnational public policy

notion, 1.4[4]  
relevance in international arbitration, 1.4[4]  
See Mandatory rules, Illegality

### Unequal bargaining power

See Gross disparity

### Unilateral declarations

invalidity of, 3.2.17  
See Interpretation of Statements and other conduct, Notice

## UNIDROIT Principles

as model for legislators, Preamble[7]  
as rules of law governing contract, Preamble[4]  
applied as *lex mercatoria*, Preamble[4]  
applied in absence of any choice by parties, Preamble[4(c)]  
express choice by parties, Preamble[4(a)]  
in conjunction with arbitration clause, Preamble[4]  
other possible uses, Preamble[8]  
to interpret domestic law, Preamble[6]  
to interpret other international instruments, Preamble[6]  
definitions, 1.11  
commercial contracts, Preamble[2]



## Index

court, 1.11[1]  
international contracts, Preamble[1]  
place of business, 1.11[2]  
obligor-obligee, 1.11[3]  
writing, 1.11[4]  
exclusion and modification of, 1.5[1]  
by implication, 1.5[2]  
mandatory provisions, 1.1[3], 1.5[3],  
1.7[4], 1.9[6], 3.1.4, 5.1.7[2], 7.1.6,  
7.4.13  
general principles underlying, 1.6[4]  
absence of specific requirements as  
to form, 1.2[1], 1.10[1]  
freedom of contract, 1.1[1], 1.5[1]  
full compensation, 7.1.1, 7.4.2[1]  
good faith and fair dealing, 1.7[1]  
*pacta sunt servanda*, 1.3[1]  
reasonableness, 1.8[2], 4.1[2],  
4.1[4], 4.2[2], 4.3[2], 4.8[3], 5.1.2,  
5.1.6[2], 5.1.7[1]  
interpretation of, 1.6[1]  
interpretation of contract distin-  
guished, 1.6[1]  
regard to be had to international  
character, 1.6[2]  
regard to be had to purposes, 1.6[3]  
mandatory rules prevail over, 1.1[3],  
1.3[1], 1.4[1]  
when Principles govern contract,  
Preamble[3], Preamble[4], 1.4[3]  
when Principles incorporated into  
contract, 1.4[2]  
consumer transactions,  
Preamble[2]  
determination of applicable  
mandatory rules, 1.4[4]  
determination of relevant public  
permission requirements,  
6.1.14[1]  
effects of contract on third persons,  
1.3[3]  
lack of capacity, 3.1.1, 3.1.3[2]  
“real” contracts, 3.1.2[3]  
rights of third persons in case of  
restitution, 7.3.6[5]  
scope of, Preamble  
commercial contracts, Preamble[2]  
international contracts, Preamble[1]  
Principles applied to domestic  
contract, Preamble[3]  
supplementation of, 1.6[4]  
by analogy with other provisions,  
1.6[4]

by reference to general principles  
underlying, 1.6[4]  
by reference to particular domestic  
law, 1.6[4]  
usages and course of dealing prevail  
over, 1.9[6]  
See Arbitration, Private international  
law

### Usages

binding character of, 1.9[1]  
agreed usages, 1.9[3]  
in absence of agreement, 1.9[4]  
local usages, 1.9[4]  
subject to standard of reasonable-  
ness, 1.9[5]  
circumstance relevant to interpretation,  
4.3[2],  
mistake, 3.2.2[1]  
means of overcoming indefiniteness,  
2.1.2[1]  
modes of acceptance and, 2.1.6[3],  
2.1.6[4], 2.1.7  
order of performance determined by,  
6.1.4, 6.1.4[1]  
requiring replacement transaction,  
7.2.1, 7.4.5[1]  
source of implied obligation, 5.1.2  
standard terms and, 2.1.19[3]  
UNIDROIT Principles superseded by,  
1.9[6]  
See Practices

### Validity of contract

grounds of invalidity not covered, 3.1.1  
mandatory provisions concerning,  
1.5[3]  
public permission requirements affect-  
ing, 6.1.14[1], 6.1.16[2], 6.1.17[2],  
7.2.2[3]  
See Contract, Fraud, Gross disparity,  
Initial impossibility, Mistake, Public  
permission requirements, Terms of  
contract, Threat, Unilateral  
declarations

### *Venire contra factum proprium*

See Inconsistent behaviour

### *Wegfall der Geschäft sgrundlage*

See Hardship

## UNIDROIT Principles

### Writing

defined, 1.11[4]

electronic communications and, 1.11[4]

### Writings in confirmation

defined, 2.1.12[1]

invoice as, 2.1.12[3]

time period for sending of, 2.1.12[2]

varying terms of contract, 2.1.12[1]

acceptance varying terms compared,

2.1.12[1]

non-material alterations and,

2.1.12[1]

See Acceptance